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1997 Annual Report

DRAXIS Health Inc.



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## Stock Symbols

DRAXIS Health Inc.

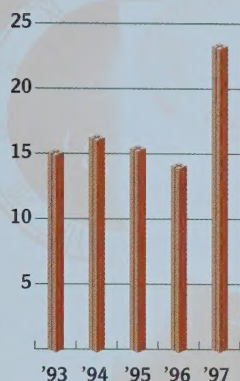
TSE: DAX

NASDAQ: DRAXF

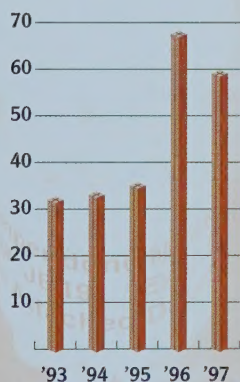
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## 1997 Highlights

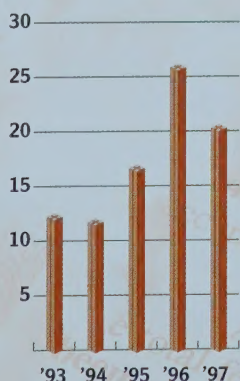
**Revenues**  
(\$ millions)



**Assets**  
(\$ millions)



**Cash and Cash Equivalents**  
(\$ millions)



**January** • Acquisition of Canadian rights to cancer drug from Mylan Laboratories Inc.

**February** • FDA acceptance of efficacy claim for Anipryl® for canine Cushing's disease  
• HPB approval of Anipryl for canine cognitive dysfunction syndrome  
• Acquisition of Spectro-Pharm Inc.  
• Issuance of patent for Anipryl by Canadian Intellectual Property Office

**March** • Agreement with GenDerm Canada Inc. for the exclusive right to promote Zonalon®  
• Issuance of patent for Anipryl by European Patent Office

**June** • FDA approval of Anipryl for the treatment of canine Cushing's disease  
• US market launch of Anipryl

**July** • Acquisition of radiopharmaceutical division of Merck Frosst Canada Inc. which begins its operations as Draximage Inc.

**September** • Submission of supplemental application for Anipryl with FDA  
• Commencement of Phase I study of Deep Vein Thrombosis (DVT) imaging product – Fibrimage™  
• Announcement of Canadian collaboration with Mylan Laboratories Inc.

**December** • Worldwide Anipryl alliance between DRAXIS and Pfizer Inc.

## 1998 Highlights

**January** • Announcement of R&D priorities and intention to commit \$3.5 million to R&D in 1998 – R&D to focus on Draximage pipeline

**March** • Announcement of memorandum of agreement to acquire Québec pharmaceutical manufacturing facility from IVAX Corporation

## Selected Financial Data

(in thousands of Canadian dollars except share related data)

	1997	1996	1995	1994	1993
Revenues	\$ 23,290	\$ 14,100	\$ 15,434	\$ 16,243	\$ 15,087
Research and Development Expenses	2,271	1,444	1,937	1,545	2,235
EBITDA <sup>1</sup>	(6,017)	(5,193)	653	4,968	1,386
Net (Loss) Income	(20,923) <sup>2</sup>	(166)	2,417	1,099	(2,079)
Cash and Cash Equivalents	20,262	25,828	16,606	11,691	12,205
Total Assets	59,078	67,539	35,052	33,062	31,986
<b>Per Common Share</b>					
Net (Loss) Income	\$ (0.70) <sup>2</sup>	\$ (0.01)	\$ 0.12	\$ 0.06	\$ (0.11)
Shareholders' Equity	1.57	2.18	1.48	1.36	1.31

<sup>1</sup> Earnings (loss) before depreciation and amortization, financial income (expense), income taxes and equity share of loss of affiliated companies.

<sup>2</sup> Includes non-recurring expenses aggregating \$9,315,000 (see Note 11 to the Consolidated Financial Statements).



**Martin Barkin, MD,  
BScMed, MA, FRCSC  
President and CEO**

*DRAXIS is an emerging, diversified pharmaceutical company operating in specific medical niches through four operating units: Deprenyl Animal Health, DRAXIS Pharmaceutica, SpectroPharm Dermatology and Draximage. DRAXIS' mission is to create increasing shareholder value through the development and commercialization of market ready and late stage pharmaceutical opportunities in well defined niches.*

## To Our Shareholders:

1997 saw the fastest pace yet in our quest to achieve growth through acquisition in specific niche areas that take us into the global pharmaceutical marketplace.

We completed the acquisitions of SpectroPharm and Draximage. By the fourth quarter, quarterly revenues from our diversified operational base more than doubled as compared to the fourth quarter of 1996.

In 1997, the HPB approved Anipryl for canine cognitive dysfunction syndrome and the FDA approved it for canine Cushing's disease. We submitted the cognitive indication to the FDA and both indications in Australia, New Zealand and the U.K. Additional patents were issued in various countries around the world.

In December, we entered into a landmark global alliance with Pfizer Inc. for the worldwide marketing of Anipryl in exchange for milestones, royalties, a supply agreement and a research and development collaboration.

Draximage, our new radiopharmaceutical division, entered the DRAXIS group in July 1997, bringing from its former parent, Merck Frosst Canada Inc., its management, scientists, staff, existing product line and its pipeline of new products which we will continue to develop for regulatory approval around the world.

In March 1998, we announced that DRAXIS had entered into a non-binding memorandum of agreement for the acquisition of a pharmaceutical manufacturing facility in Québec, which will provide a permanent home for Draximage.

SpectroPharm Dermatology markets and sells the number one product in its category of non-soap skin cleansers in Canada – SpectroJel®. It is now working to introduce this product into the much larger US marketplace.

DRAXIS Pharmaceutica, which develops, markets and sells prescription pharmaceutical products in Canada, announced its alliance with Mylan Laboratories Inc. and the first product under that alliance, Mylan's paclitaxel.

DRAXIS' shares stood out from the relatively weak public equities markets for Canadian Life Science's companies, increasing 37%, based on year-end trading levels. This performance continued the growth trend which began in 1994.

We are proud of our accomplishments in 1997, but we are not complacent. Our management team, directors and employees are committed to continuing the growth of our businesses both from their existing product lines and territories and from the entry into new product lines and territories.

We thank our customers, shareholders, board of directors, employees, corporate partners, sales associates and distributors for their continuing support.

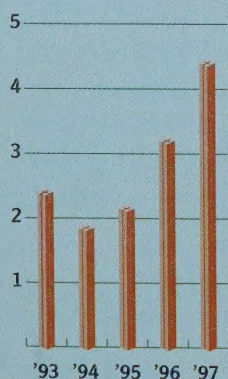
Sincerely,

Dr. Martin Barkin

April 30, 1998

### Closing Share Price

(TSE: December 31)



## The Anipryl Story

*Deprenyl Animal Health, Inc.*

*In alliance with the Animal Health Division of Pfizer Inc., to realize the full potential of Anipryl as a global companion animal product.*

1990 • DAHI founded by DRAXIS

1991 • DAHI initial public offering

1992 • Begin clinical trials for canine Cushing's disease and canine cognitive dysfunction syndrome

1994 • NDS filed with the HPB for canine Cushing's disease

1995 • NADA filed with the FDA for canine Cushing's disease

• HPB approval for canine Cushing's disease

1996 • NDS filed with the HPB for canine cognitive dysfunction syndrome  
• DRAXIS reacquires 100% of DAHI

1997 • HPB approval for canine cognitive dysfunction syndrome  
• FDA approval for canine Cushing's disease  
• NADA filed with the FDA for canine cognitive dysfunction syndrome  
• Submissions filed in Australia, New Zealand, U.K. for cognitive and Cushing's disease

## *DRAXIS Licenses Global Market Rights for Anipryl to Pfizer Inc.*

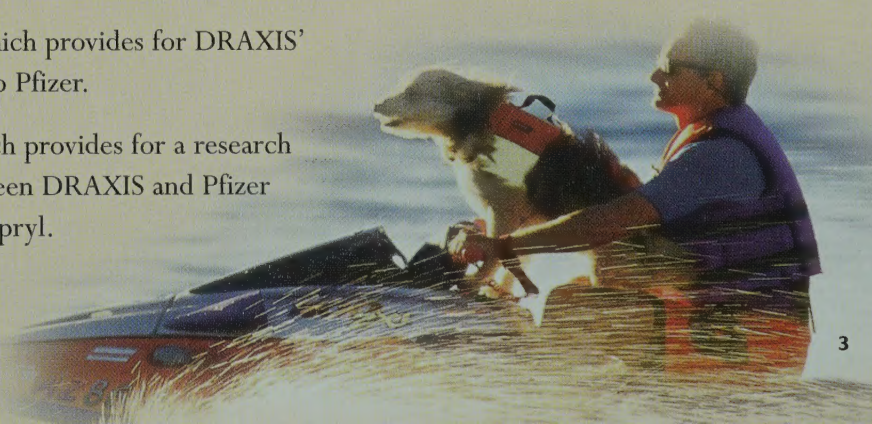
In December 1997, DRAXIS entered into a global alliance with Pfizer Inc. whereby Pfizer assumed the worldwide marketing and selling responsibilities for Anipryl as part of a comprehensive four-part arrangement, which included:

**License Agreement** which provides for milestone payments to be received upon the achievement of specified events.

**Royalty Agreement** which provides for royalties based on Pfizer's worldwide sales of Anipryl.

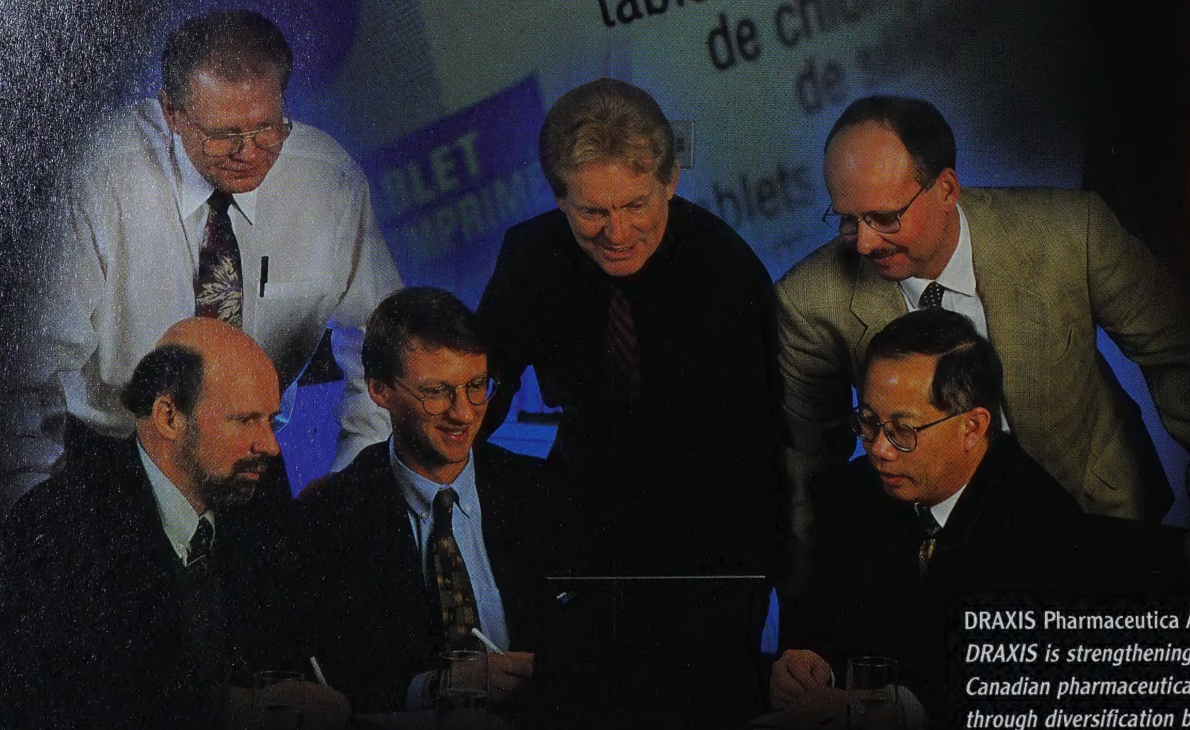
**Supply Agreement** which provides for DRAXIS' supply of Anipryl to Pfizer.

**R&D Agreement** which provides for a research collaboration between DRAXIS and Pfizer with respect to Anipryl.





DIN 0079  
**Pr ELDEPR**  
selegiline hydrochloride  
tablets / comprimés  
de chlorure de selegiline



**DRAXIS** Pharmaceutica Area Managers  
*DRAXIS is strengthening its position in  
Canadian pharmaceutical marketing  
through diversification both within,  
and outside of neurology*

## DRAXIS Pharmaceutica

**DRAXIS**  
**Pharmaceutica's**  
*role is to acquire,*  
*develop and market*  
*late stage or*  
*market ready*  
*prescription*  
*pharmaceutical*  
*products for*  
*the Canadian*  
*marketplace.*

Jacqueline H. R. Le Saux,  
 President,  
 DRAXIS Pharmaceutica

In October 1997, DRAXIS' Canadian sales and marketing operations commenced operating under the name DRAXIS Pharmaceutica.

### Parkinson's Disease

DRAXIS Pharmaceutica is one of the leading pharmaceutical marketers in Canada for Parkinson's disease, with an approximate 20% market share in 1997. Pharmaceutica holds the Canadian marketing rights to a family of prescription products for the treatment of the various phases of Parkinson's disease, including Eldepryl®, Novo-Selegiline, Permax® (licensed from Eli Lilly Canada Inc.) and Britaject®.

During 1997, Pharmaceutica again sponsored a series of grand rounds in several major Canadian teaching centres conducted by world-renowned Parkinson's experts, Drs. Warren Olanow and Peter Jenner.

DRAXIS is strengthening its position in the Canadian pharmaceutical marketplace through diversification both within, and outside of neurology, by obtaining the Canadian rights to a number of products which are undergoing regulatory review or which are in late stage development.

### Sleep Disorders

DRAXIS carried out successful Phase III clinical studies on Alertec® (modafinil) licensed from Laboratoire L. Lafon of France for the treatment of narcolepsy. These studies were in support of its submission to the HPB which is currently under review with approval expected in 1998. Narcolepsy affects up to 30,000 Canadians each year. Canada has not approved a new treatment for narcolepsy since 1959.

### Metabolic Bone Disease

One-alpha D<sub>2</sub> is a drug for the treatment of secondary hyperparathyroidism of renal failure, a complication that can affect patients on dialysis. One-alpha D<sub>2</sub> is being developed by Bone Care International, Inc. and in March 1998 it submitted a new drug application with the US Food and Drug Administration for an oral formulation of this product. DRAXIS holds the Canadian rights to this drug for all metabolic bone disease applications.

### Cancer

Paclitaxel (taxol), a potent anti-cancer drug, is a novel, anti-tumour agent used in the treatment of refractory breast and ovarian cancer, and is the leading cytotoxic agent in North America. In early 1997, DRAXIS obtained the exclusive Canadian marketing rights to the Mylan formulation of paclitaxel. DRAXIS will be responsible for obtaining HPB approval for the product and for the marketing, distribution and sale of Mylan's paclitaxel in Canada.

### Mylan Alliance

To further enhance the Pharmaceutica product line, DRAXIS and Mylan Laboratories Inc. have developed a framework for an ongoing collaboration, under which Pharmaceutica will introduce, in Canada, Mylan products identified by the parties from time to time which fit within DRAXIS' strategic niches. Mylan has an extensive line of generic products on the market and in development in the United States and is working on a number of innovative products.

## SpectroPharm Dermatology

*Building on its leading position in the Canadian marketplace, SpectroPharm Dermatology's role is to develop and market, on a global basis, prescription and ethical non-prescription skin care products.*

**Teri Puccini-Staley,**  
President,  
SpectroPharm  
Dermatology

Following the acquisition of Spectro-Pharm Inc., DRAXIS' dermatology and podiatry lines were consolidated and in October 1997, commenced operating under the name SpectroPharm Dermatology.

### SpectroJel/SpectroDerm

SpectroJel continues to be the number one ranked non-soap skin cleanser in Canada and is SpectroPharm's flagship product. Fueled by a 43% sales increase in 1997, SpectroJel's growth outpaced the market and its major competitors with the brand achieving an approximate 20% market share. 1997 sales for the total SpectroPharm line of products, which includes cleansers, creams and topical steroids, grew by 48%.

SpectroPharm products are now easier for Canadian consumers to find. Product distribution increased as a result of obtaining new listings with major chains and increased shelf presence. SpectroPharm's professional representatives continued to increase demand for its products through promotion to dermatologists and general practitioners across Canada.

SpectroPharm initiated its entry into the United States dermatology marketplace at the end of 1997 with its flagship brand SpectroJel (United States trademark name, SpectroDerm®). The United States market represents a significant opportunity for SpectroPharm owing to its size and, like Canada, dermatologists recommend non-soap cleansers to an average of 39 patients per week. Like SpectroJel, SpectroDerm is distinguishable for its lack of irritants as well as its moisturizing properties and has been positioned as the everyday cleanser for people with sensitive skin. By mid-1998, SpectroPharm expects to achieve maximum distribution in the United States by obtaining listings in the five major drug chains and in two of the largest wholesalers. An independent professional detailing sales force has been engaged to create demand through promotion to the 7,500 dermatologists in the United States.

The outlook for 1998 is positive for SpectroPharm Dermatology based on increased distribution of its products and the increase in physician recommendations that help fuel consumer demand.

### Business Development Opportunities

The most significant opportunities for growth are expected to come from expanding the territories of distribution of the SpectroPharm line from Canada, into the United States, Europe and the Pacific Rim. Out-licensing partners in Europe and the Far East are being evaluated to market the SpectroPharm line of products worldwide.

*SpectroPharm  
Dermatology  
Business Unit  
Growth has  
continued in 1998  
as distribution  
begins to expand  
into the US*



In October 1997, Levulan<sup>®</sup>'s developer, DUSA Pharmaceuticals, Inc., announced positive results from its Phase III clinical trials with Levulan Photodynamic Therapy for actinic keratoses. DUSA also announced the initiation of a Phase I/II multicentre clinical trial using Levulan for the photo detection of bladder cancer. DRAXIS holds the Canadian rights to Levulan for all indications.

In early 1998, DRAXIS concluded that the results of its research into the development of prescription pharmaceuticals based on the liposomal delivery system, together with the uncertainty concerning the timing of successfully developing a commercializable formulation, no longer justified the considerable further investment that would be required to pursue this line of research.

SpectroPharm's Montréal-based research team is developing a range of OTC line extensions to complement its line of existing products. Through this research and development effort, SpectroPharm Dermatology will solidify its position in the marketplace as a complete skincare provider.

*SpectroPharm  
Dermatology  
Area Managers  
Fueled by a 43%  
sales increase in  
1997, SpectroJel's  
growth outpaced  
the market*



*Draximage's role is to research, develop, manufacture and market diagnostic and therapeutic products for use in nuclear medicine.*

**Raymond Doré**  
President,  
Draximage Inc.

## Draximage Inc.

Draximage Inc. (formerly the radiopharmaceutical division of Merck Frosst Canada Inc.) is located in Kirkland, Québec. Frosst Radiopharmaceuticals was a pioneer and a leader in the medical application of nuclear technology after assuming the development function from Atomic Energy of Canada Ltd. in the early 1950's. Draximage is the only fully integrated manufacturer of radiopharmaceutical products in Canada.

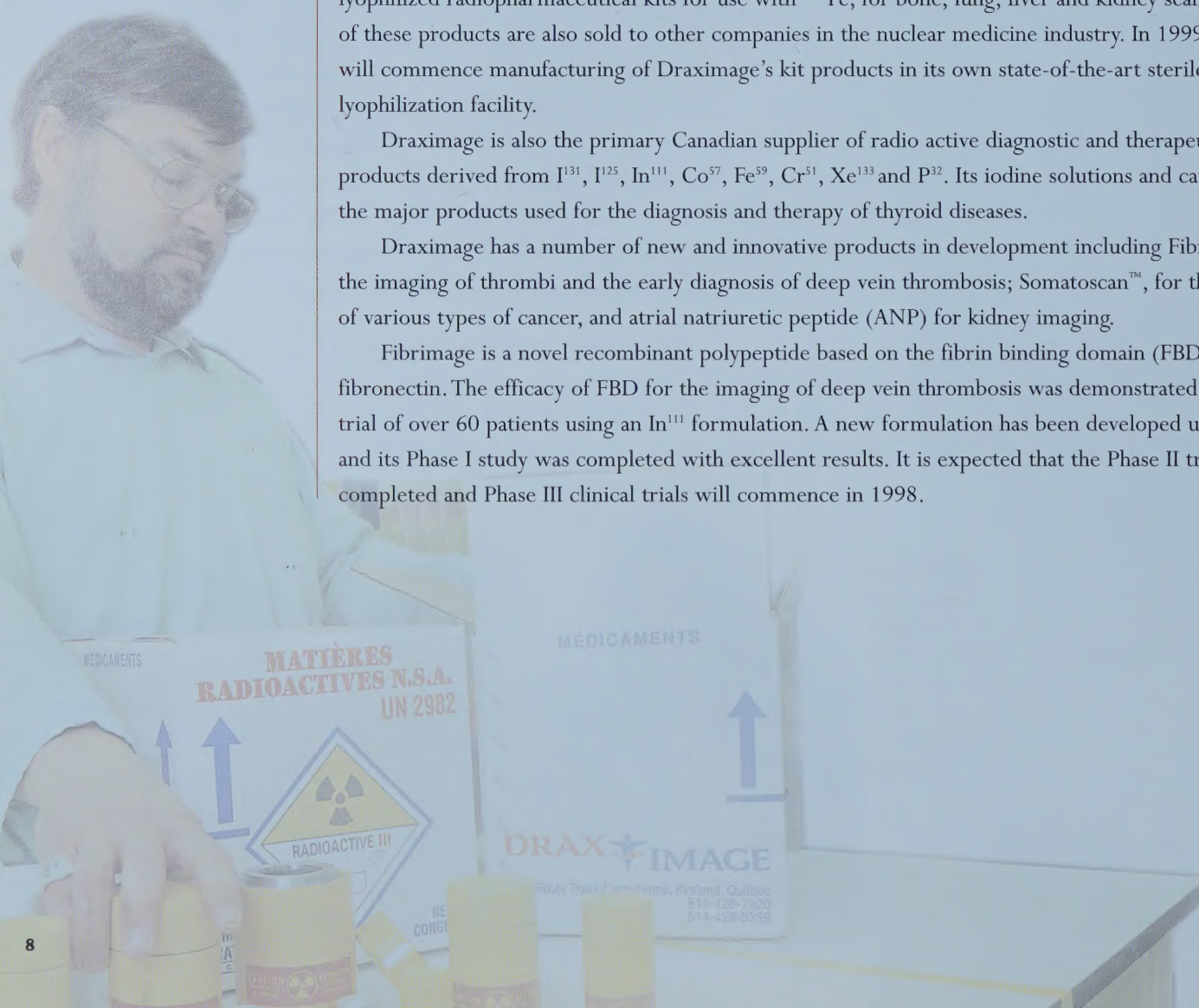
Draximage is active in research and development and has a long history of technological and scientific progress. The company was one of the first to develop lyophilized kits for the in-situ preparation of technetium-99m ( $^{99m}\text{Tc}$ ) radiopharmaceuticals and was a leader in identifying the critical role that peptides would play in the expanding role of nuclear medicine. It successfully developed chelates (the molecular entities which permit the attachment of metals to biologically active molecules) for both the indium/yttrium and technetium/rhenium group of metals. Draximage also developed crucial stabilizers for iodinated radiopharmaceuticals and is one of the few companies to market iodinated products that do not require refrigeration.

Draximage operates GMP-compliant manufacturing and quality control departments which are licensed by regulatory agencies in Canada, US and the European community. It is a primary source of lyophilized radiopharmaceutical kits for use with  $^{99m}\text{Tc}$ , for bone, lung, liver and kidney scans. Many of these products are also sold to other companies in the nuclear medicine industry. In 1999, DRAXIS will commence manufacturing of Draximage's kit products in its own state-of-the-art sterile lyophilization facility.

Draximage is also the primary Canadian supplier of radio active diagnostic and therapeutic products derived from  $\text{I}^{131}$ ,  $\text{I}^{125}$ ,  $\text{In}^{111}$ ,  $\text{Co}^{57}$ ,  $\text{Fe}^{59}$ ,  $\text{Cr}^{51}$ ,  $\text{Xe}^{133}$  and  $\text{P}^{32}$ . Its iodine solutions and capsules are the major products used for the diagnosis and therapy of thyroid diseases.

Draximage has a number of new and innovative products in development including Fibrimage, for the imaging of thrombi and the early diagnosis of deep vein thrombosis; Somatoscan<sup>TM</sup>, for the imaging of various types of cancer, and atrial natriuretic peptide (ANP) for kidney imaging.

Fibrimage is a novel recombinant polypeptide based on the fibrin binding domain (FBD) of human fibronectin. The efficacy of FBD for the imaging of deep vein thrombosis was demonstrated in a clinical trial of over 60 patients using an  $\text{In}^{111}$  formulation. A new formulation has been developed using  $^{99m}\text{Tc}$  and its Phase I study was completed with excellent results. It is expected that the Phase II trial will be completed and Phase III clinical trials will commence in 1998.





Raymond Doré  
President

Somatoscan is a novel hexapeptide based on Merck's MK-678 which is coupled to Draximage's proprietary HDTD chelator for the imaging of somatostatin-positive tumours such as neuroendocrine tumours, lymphomas and small cell lung cancer. A clinical trial involving over 65 patients using an  $I^{131}$  analogue of MK-678 successfully imaged all the common neuroendocrine tumour types including insulomas, vipomas, carcinoid and medullary thyroid carcinoma as well as non-endocrine tumour types such as lymphoma and multiple endocrine neoplasia. It is expected that the Phase I trial of Somatoscan will be completed and the Phase II trial will commence in 1998.

ANP is a potent cardiac peptide which acts on the kidney to control blood pressure and volume. Radiolabeled ANP has demonstrated high binding affinity to receptors in both the lung and kidney. Experimental results have demonstrated efficacy in the detection of kidney dysfunction associated with such diseases as diabetes, essential hypertension and reno-vascular hypertension induced by the stenosis of renal arteries.

Draximage also provides labeling technology for other companies for use with monoclonal antibodies and peptides and is working on the development of a number of novel therapeutic uses of radioactivity.



Dr. Richard Flanagan  
Executive Vice President



## Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and the related Notes to the Consolidated Financial Statements.

The discussion and analysis for 1996 and 1995 has been modified and expanded relative to the presentation contained in the 1996 Annual Report in order to conform to the 1997 presentation which is more representative of DRAXIS' current business organization and financial presentation.

### Revenues

- 1997** Product revenues for DRAXIS Health Inc. ("DRAXIS" or the "Company") increased by \$9,190,000 or 65.0% for the year ended December 31, 1997 as compared to the previous fiscal year.
- DRAXIS Pharmaceutica* – Sales of DRAXIS Pharmaceutica in 1997 declined by \$2,060,000 or 15.9%. Combined sales of the Company's two selegiline drugs, *Eldepryl*® and *Novo-Selegiline*, declined by \$2,041,000 to \$6,860,000 in 1997 from \$8,901,000 in 1996 due to increased competition which resulted in lower prices for *Novo-Selegiline* and lower unit sales for *Eldepryl*®. The decline in selegiline sales was partially offset by increased sales of *Permax*®. 1996 sales also included sales of the drug *Prolopa*® and a payment received by the Company associated with the early return of the Canadian marketing and selling rights for this drug to Hoffmann-La Roche Limited in December 1996.
- SpectroPharm Dermatology* – Sales of SpectroPharm Dermatology increased \$4,455,000 from \$864,000 in 1996 to \$5,319,000 in 1997 largely as a result of the acquisition of Spectro-Pharm Inc. in February 1997.
- Draximage* – Sales of Draximage commenced effective July 1, 1997 following the acquisition of the radiopharmaceutical division of Merck Frosst Canada Inc. 1997 sales for this unit totalled \$3,123,000.
- Veterinary* – Sales of the Company's veterinary business increased \$3,672,000 from \$280,000 in 1996 to \$3,952,000 in 1997 as a result of the commencement of sales of *Anipryl*® in the United States, initial inventory sales of *Anipryl*® to Pfizer Inc. in the fourth quarter of 1997 and increased sales of *Anipryl*® in Canada.
- 1996** Product revenues for DRAXIS declined by \$1,334,000 or 8.6% for the year ended December 31, 1996 as compared to the previous fiscal year.
- DRAXIS Pharmaceutica* – Sales of the Canadian Pharmaceutical unit in 1996 declined by \$2,224,000 or 14.7%. This decrease was largely attributable to the lower proportion of DRAXIS' branded drug, *Eldepryl*®, and the introduction of the lower-priced generic version, *Novo-Selegiline*. Combined sales of the two selegiline drugs declined by \$3,230,000 to \$8,901,000 in 1996 from \$12,131,000 in 1995. The decline in selegiline sales was partially offset by increased sales of *Permax*®. Sales were also affected by the sale of IHS to Stéf International Corporation ("Stéf") in August 1996 and the subsequent exclusion of that company's revenues from DRAXIS' revenues. DRAXIS' share of IHS's 1996 sales to the date of disposition were \$366,000. Sales were also affected by the payment associated with the early return of the Canadian marketing and selling rights for the drug *Prolopa*® to Hoffmann-La Roche Limited.
- SpectroPharm Dermatology* – Dermatology sales increased by \$610,000 in 1996 over 1995 levels as a result of the acquisition of Tican Pharmaceuticals Ltd. in July 1996 and the commencement of sales of *Kerasal*® in the United States following its market launch in April 1996.
- Veterinary* – Sales of the Company's veterinary business totalled \$280,000 for 1996 representing sales of *Anipryl*® in Canada following the market launch in Canada in April 1996.
- 1995** Product revenues for DRAXIS declined by \$809,000 or 5.0% for the year ended December 31, 1995 in comparison to the previous fiscal year.

## Management's Discussion and Analysis of Financial Condition and Results of Operations *continued*

*DRAXIS Pharmaceutica* – Sales of the Canadian Pharmaceutical unit in 1995 declined by \$793,000 or 5.0% despite the fact that volume sales of selegiline (in number of tablets sold) rose by 7.6% over the previous year. Sales declined because an increasing proportion of the Company's selegiline sales were of the lower-priced *Novo-Selegiline* product. As a result, combined sales of *Eldepryl*® and *Novo-Selegiline* declined by \$1,947,000 or 13.8%. A 25.3% increase in sales of *Permax*® and nine month sales of approximately \$600,000 from the Company's joint venture in IHS helped offset the decline of selegiline revenues.

On October 1, 1995, *Novo-Selegiline* was listed on the Ontario Drug Benefit Plan. Novopharm Limited, one of the world's largest generic companies, now distributes *Novo-Selegiline* in Canada, and is expected by the Company to maintain a significant share of the generic selegiline market even after the introduction of other generic versions of selegiline. DRAXIS and Novopharm Limited share equally in the profits of these sales.

*SpectroPharm Dermatology* – Dermatology sales totalled \$254,000 in 1995 representing sales of the Company's OTC liposomal products in Canada.

### *Cost of Sales*

1997 Cost of sales increased from 22.0% of sales in 1996 to 32.4% in 1997 due to a significant change in product mix which occurred during the year. Sales of the relatively higher margin products in DRAXIS Pharmaceutica and DAHI declined from 93.8% of total revenues in 1996 to 63.8% in 1997 with a corresponding increase in the proportion of relatively lower margin sales of SpectroPharm Dermatology and Draximage products.

1996 Cost of sales increased from 20.8% of sales in 1995 to 22.0% in 1996 arising from the change in product mix described above.

1995 Cost of sales increased from 18.0% of sales in 1994 to 20.8% in 1995 arising from the change in product mix described above.

### *Selling, General and Administration Expenses*

1997 Selling, general and administration expenses increased \$4,745,000 to \$19,781,000 in 1997 as a result of the acquisition of Spectro-Pharm Inc. and the subsequent expansion of marketing activities in this business unit in Canada and the United States, the acquisition of the radiopharmaceutical division of Merck Frosst Canada Inc. and the consolidation of Deprenyl Animal Health, Inc.'s ("DAHI's") operating expenses for all of 1997 as compared to only one month in 1996. DAHI's 1997 operating expenses increased over 1996 as a result of higher marketing and selling costs in preparation for and following the launch of *Anipryl*® in the United States.

1996 Selling, general and administration expenses increased \$4,918,000 in 1996 due mainly to higher marketing and selling costs associated with the market launches of *Kerasal*® into the United States and *Anipryl*® in Canada and the decline from 95% to 50% of DRAXIS' share of profits under the arrangement with Novopharm Limited. Selling, general and administration expenses in 1996 also increased relative to 1995 due to the consolidation of DAHI's operating expenses for the period from completion of the share exchange transaction (i.e., December 1, 1996) to December 31, 1996.

1995 Selling, general and administration expenses in 1995 increased \$2,852,000 or 39.3% over the year earlier. A significant part of this increase is attributable to increased marketing, distribution, and profit sharing costs associated with the profit sharing arrangement with Novopharm Limited. Also responsible for this increase were costs associated with the launch of *Kerasal*® into the United States and non-recurring costs associated with the start up of IHS and the subsequent restructuring, repositioning and relaunch of its product line. Partially offsetting these increases was a decrease in the Lipopharm division operating costs. All other operating costs were approximately the same as in the prior year.

## Management's Discussion and Analysis of Financial Condition and Results of Operations *continued*

### *Research and Development*

**1997** *Research and Development Expenditures* – Research and development expenditures in 1997 increased to \$2,271,000 from \$1,444,000 in 1996 largely as a result of the acquisition of the radiopharmaceutical division of Merck Frosst Canada Inc. and the consolidation of DAHI's research and development expenditures for all of 1997 as compared to only one month in 1996.

*Investment Tax Credits on Research and Development Expenditures* – Investment tax credits declined from 20.5% of research and development expenditures in 1996 to 12.3% in 1997 largely as a result of the inclusion of DAHI's research and development expenditures, which are not eligible for Canadian research and development tax credits.

**1996** *Research and Development Expenditures* – Research and development costs in 1996 declined to \$1,444,000 from \$1,937,000 a year earlier following substantial completion of the development of *Alertec*® (i.e. modafinil) in the first half of 1996. Research and development activity on *LipoTeca*™ continued during the year. These expenditures will increase as new products are added to the development pipeline. The decline in research and development costs in 1996 was partly offset as a result of the consolidation of DAHI's research and development costs for the period from completion of the share exchange transaction (i.e., December 1, 1996) to December 31, 1996.

*Investment Tax Credits on Research and Development Expenditures* – Investment tax credits were largely unchanged from 20.9% of research and development expenditures, before recoveries from an affiliated company, in 1995 to 20.5% in 1996.

**1995** *Research and Development Expenditures* – Research and development costs in 1995, mainly associated with the development of *Alertec*® and *LipoTeca*™ increased 25.4% to \$1,937,000 from \$1,545,000 one year earlier. *Alertec*® results showed a statistically significant difference in reducing excessive somnolence in narcoleptic patients when compared to a placebo. Similarly, the first clinical study with *LipoTeca*™ demonstrated a statistically significant difference against placebo in the treatment of keloids.

The Company received permission to market a liquid form of *Eldepryl*® in Canada, but has determined to delay its launch of this product until it has completed further tests to determine the most appropriate use of the drug.

*Investment Tax Credits on Research and Development Expenditures* – Investment tax credits were largely unchanged from 21.9% of research and development expenditures, before recoveries from an affiliated company, in 1994 to 20.9% in 1995.

### *Depreciation and Amortization*

**1997** Depreciation and amortization expense increased by \$3,823,000 to \$5,518,000 in 1997 as compared to \$1,695,000 in 1996. This increase is largely attributable to increased amortization expense associated with the completion of the DAHI share exchange transaction in November 1996, the commencement of amortization of goodwill incurred on the acquisition of Spectro-Pharm Inc. in February 1997 and depreciation and amortization charges which commenced following the acquisition of the radiopharmaceutical division of Merck Frosst Canada Inc. effective July 1, 1997.

**1996** Effective January 1, 1996, DRAXIS adopted a policy of amortizing the cost of product licenses on a straight line basis over the minimum term of the related license agreements. Prior to 1996, the cost of product licenses were amortized on the basis of actual product sales during a period as a percentage of total estimated sales over the minimum term of the related license agreement. As the aggregate, cumulative effect of this change on prior periods is not significant, prior years' figures have not been restated.

## Management's Discussion and Analysis of Financial Condition and Results of Operations *continued*

Amortization and depreciation expense increased by \$410,000 to \$1,695,000 in 1996 as compared to \$1,285,000 in 1995. This increase is attributable to the change in accounting policy described above, increased fixed asset depreciation, the commencement of the amortization of the cost of the *Anipryl*® US patent rights and Canadian license and goodwill associated with the acquisition of Tican Pharmaceuticals Ltd.

**1995** Included in this expense category in 1995 are the amortization of the cost of the Company's *Eldepryl*® and *Permax*® licenses with Somerset Pharmaceuticals, Inc. and Eli Lilly Canada Inc., respectively, which were amortized on the basis of actual sales during the year as a percentage of anticipated sales over the term of the licenses, the amortization of the goodwill on the acquisition of Lipopharm and the depreciation of fixed assets.

On October 1, 1995, The Ontario Drug Formulary made *Eldepryl*® subject to generic substitution, the last formulary to do so. As a direct consequence, the Company decided to review its sales forecast of both *Eldepryl*® and *Permax*® and accelerated the amortization of both of these licenses, incurring an increase in the annual rate of amortization of approximately \$296,000.

Amortization and depreciation expense increased by \$419,000 to \$1,285,000 in 1995 as compared to \$866,000 in 1994. This increase is attributable to the increased rate of amortization described above and increased fixed asset depreciation.

### *Financial*

**1997** *Interest Income* – Interest income declined by \$848,000 to \$654,000 for the year ended December 31, 1997 as compared to the previous year principally as a result of lower cash balances during the year following the acquisition of Spectro-Pharm Inc. and the funding of operating losses.

*Financing Expense* – Financing expense increased from nil in 1996 to \$1,092,000 in 1997 as a result of interest and related charges associated with the \$13,977,000 of debt financing incurred in conjunction with the acquisition of the radiopharmaceutical division of Merck Frosst Canada Inc. prior to the repayment of \$10,000,000 of such financing in December 1997.

**1996** *Interest Income* – Interest income improved by \$305,000, or 25.5%, to \$1,502,000 for the year ended December 31, 1996 compared to the previous year, principally as a result of higher average cash balances arising from the net proceeds of \$11,600,000 from a public offering of three million common shares in April 1996 and the net proceeds of \$9,300,000 from the sale of DRAXIS' remaining interest in DUSA Pharmaceuticals, Inc. ("DUSA") in March 1996.

**1995** *Interest Income* – Interest income increased \$354,000, or 41.9%, to \$1,197,000 during the 1995 year compared to \$843,000 for the previous year mainly due to higher average cash reserves.

### *Other Income (Expense)*

**1997** *Loss on Sale of Product Rights* – In December 1997, DRAXIS entered into a global alliance with Pfizer Inc. with respect to *Anipryl*®. This transaction was accounted for as a disposition of the Company's interest in *Anipryl*® which triggered a writedown of DRAXIS' full carrying value of *Anipryl*® against the first milestone payment of US\$15,090,000, resulting in a one-time loss of \$6,756,000, after provision for transaction and restructuring costs. See "Equity Share of Loss of Affiliated Companies – Deprenyl Animal Health, Inc."

*Write-Down of Goodwill and Other Intangibles* – In 1997 the Company wrote-off the \$1,277,000 carrying value of goodwill and related other intangibles associated with its interest in research into the development of a prescription pharmaceutical based on a liposomal delivery system following the decision to discontinue work in this area.

*Write-Off of Stëf International Corporation* – In 1997, the Company wrote-off the \$1,282,000 carrying value of its interest in Stëf. See "Equity Share of Loss of Affiliated Companies – Stëf International Corporation".

## Management's Discussion and Analysis of Financial Condition and Results of Operations *continued*

**1996** *Gain on Sale of Securities* – During 1996, the Company disposed of its remaining interest in DUSA resulting in a pre-tax gain of \$6,001,000. In addition, during the year the Company disposed of its remaining interest in Medicis Pharmaceutical Corporation for a pre-tax gain of \$110,000.

**1995** *Gain on Sale of Securities* – DRAXIS continued the liquidation of its non-affiliate equity investments in 1995 until they were completely converted into cash and treasury bills. The gain of \$549,000 in 1995 is composed of the reversal of the 1994 reserve of \$732,000 less a loss of \$183,000 on the disposition of the remainder of the portfolio.

*Gain on Dilution of Investment* – Included as other income in 1995 is a gain of \$1,833,000 on the dilution of the Company's investment in DUSA as a result of that company's public offering in December 1995.

*Gain on Sale of Option* – Included as other income is a gain of \$3,067,000 related to the sale of DRAXIS' option to purchase two million shares of DUSA.

### **Income Taxes**

**1997** For the year ended December 31, 1997, DRAXIS recorded a recovery of income taxes of \$593,000 based on a loss before income taxes and equity share of loss of affiliated companies of \$21,288,000 as compared to a recovery of \$318,000 on income before income taxes and equity share of loss of affiliated companies of \$725,000 in 1996. The major items included in the loss before income taxes and equity share of loss of affiliated companies in 1997 but not recognized for income tax purposes include: DAHI patents and trademarks amortization; goodwill amortization arising from the acquisition of SpectroPharm Inc.; the write-down of goodwill associated with the Company's interest in liposome research and the write-off of the Company's investment in Stëf International Corporation.

**1996** For the year ended December 31, 1996, DRAXIS recorded a recovery of income taxes of \$318,000 based on income before income taxes and equity share of loss of affiliated companies of \$725,000, as compared to a provision of \$2,064,000 on income before income taxes and equity share of loss of affiliated companies of \$6,014,000 in 1995. The difference between the amount of income tax which would have been provided for in 1996 based on statutory income tax rates and the effective rate used in determining the amount of the recovery for the year is attributable to the lower effective tax rate on capital gains recognized on the sale of the Company's remaining interest in DUSA.

**1995** Income taxes increased to \$2,064,000 in 1995 from \$1,740,000 in 1994 reflecting the increase in income before income taxes. The Company's effective tax rate decreased to 34% in 1995 from 35% in 1994 due to the lower tax rate on capital gains generated by the Company during the year.

### **Equity Share of Loss of Affiliated Companies**

*Deprenyl Animal  
Health, Inc.*

On March 14, 1991, DAHI completed an initial public offering, generating US\$4,658,000 net of offering expenses to fund the development of *Anipryl*<sup>®</sup>. DRAXIS held 2,460,000 shares or 57.7% of DAHI before the public offering and was diluted to 38.8% as a result of the offering. At December 31, 1993, DRAXIS' investment in DAHI was reduced further to 33% due in large part to the exercise of stock options.

On May 1, 1994, DRAXIS advanced US\$2.5 million to DAHI in the form of convertible debt. On January 9, 1995, the Company purchased 170,000 shares of DAHI on the open market at \$2.40 per share thus increasing its equity interest to 35.7%.

## Management's Discussion and Analysis of Financial Condition and Results of Operations *continued*

As at June 30, 1995, the Company's equity share of the losses of DAHI had fully amortized the cost of its investment in DAHI. Accordingly, the Company was not required to and did not equity account for any further losses of DAHI for the remainder of the year. At December 31, 1995, apart from the 1996 loan made in connection with the DAHI Distribution Agreement, the Company's management had no intention of making any further investment in DAHI. The equity share of the losses of DAHI recorded in the books of DRAXIS in 1995 was \$577,000 and the portion of unrecognized loss that would otherwise have been recorded at December 31, 1995 was \$685,000.

On January 10, 1996, the Company entered into the DAHI Distribution Agreement, under which DRAXIS acquired the rights to market *Anipryl*<sup>®</sup> in Canada in consideration of the payment of a licensing fee of US\$469,000 plus marketing expenses of US\$125,000. In connection with entering into the DAHI Distribution Agreement, DRAXIS advanced a new loan to DAHI and converted US\$1,545,000 of the 1994 loan into DAHI shares at \$2.11, acquiring 993,999 shares of DAHI in the process to hold indirectly 44%. As a result, the Company again began to record its equity share of the losses of DAHI.

In June 1996, shareholders of DAHI approved the conversion feature of the US\$1,000,000 advance made by the Company to DAHI in January 1996 and the Company clarified its commitment with respect to the future financing requirements of DAHI. As a result, in the second quarter of 1996, the Company recorded its share of DAHI's net development stage expenses of \$685,000, which had not been previously recognized for accounting purposes.

In November 1996, shareholders of both DRAXIS and DAHI approved the acquisition by DRAXIS of all the shares of DAHI not already owned by DRAXIS through a mandatory share exchange. Effective November 26, 1996, DAHI became a wholly-owned subsidiary of DRAXIS. Accordingly, the results for the fourth quarter of 1996 include the results for DAHI on a fully consolidated basis from December 1, 1996 through December 31, 1996. Prior to December 1, 1996, DAHI's results were accounted for by using the equity method and were therefore included as part of DRAXIS' equity share of loss of affiliated companies. As a result of the DAHI transaction, DRAXIS recorded an increase in patents, licenses and other deferred charges of \$27,137,000.

The Company's 1996 equity share of loss of affiliated companies includes a reversal of \$697,000 of deferred taxes which had been applied to dilution gains associated with common share offerings of DAHI in 1990 and 1991.

In December 1997, DRAXIS entered into a global alliance with Pfizer Inc. with respect to *Anipryl*<sup>®</sup>. This transaction was accounted for as a disposition of the Company's interest in *Anipryl*<sup>®</sup> which triggered a write-down of DRAXIS' full carrying value of *Anipryl*<sup>®</sup> against the first milestone payment of US\$15,090,000, resulting in a one-time loss of \$6,756,000, after provision for transaction and restructuring costs.

Pursuant to the terms of the alliance, Pfizer Inc. assumed the worldwide marketing and selling responsibilities for *Anipryl*<sup>®</sup> as part of a comprehensive four part arrangement, which included:

*License Agreement*: which provides for payments of up to US\$41,090,000 as follows: US\$15,090,000 was received in 1997 for the disposition of the Company's right title and interest in the Canadian and United States Cushing's disease registrations and the Canadian cognitive dysfunction syndrome registration, US\$10,000,000 upon receipt of FDA approval of the cognitive dysfunction supplementary claim and up to an additional US\$16,000,000 upon receipt of regulatory approvals for *Anipryl*<sup>®</sup> in specified countries.

*Royalty Agreement* which provides for royalties based on Pfizer Inc.'s worldwide sales of *Anipryl*<sup>®</sup>.

*Supply Agreement* which provides for the Company to supply *Anipryl*<sup>®</sup> to Pfizer Inc.

*R&D Agreement* which provides for a research collaboration between the Company and Pfizer Inc. with respect to *Anipryl*<sup>®</sup>.

## Management's Discussion and Analysis of Financial Condition and Results of Operations *continued*

### *DUSA Pharmaceuticals, Inc.*

On January 17, 1992, DUSA completed its initial public offering, which raised US\$14,785,000, net of offering expenses, to fund development of Levulan® Photodynamic Therapy, at which time DRAXIS' then 100% holding was diluted to 21.4%.

On March 4, 1994 and November 23, 1993, DUSA issued 250,000 and 100,000 shares, respectively, in private placements generating US\$1,700,000 in aggregate proceeds, further diluting DRAXIS' interest to 20%. On December 14, 1995, DUSA issued three million shares in a public offering generating proceeds of US\$16,500,000 before underwriting expenses. The Company's equity interest was consequently reduced from 20% to 12.8%.

On March 11, 1996, the Company sold its remaining 12.8% in DUSA in a US public offering generating net proceeds of \$9,300,000.

DRAXIS continues to hold the rights from DUSA to market all Levulan® Photodynamic Therapy products for all indications in Canada.

### *Stëf International Corporation*

In August 1996, the Company transferred its ownership interest in the joint venture IHS to Stëf. Prior to the transaction, the Company converted its loans and promissory notes due from IHS to a capital contribution, thereby increasing its ownership interest to 92%. The Company's ownership interest in IHS was then transferred to Stëf in exchange for 3,000,000 common shares valued at \$1,350,000 and a note receivable for \$728,000. The note bears interest at the bank prime rate plus 1% per annum and is payable quarterly with principal due August 6, 2001. All amounts due may be converted at the option of the Company into common shares of Stëf at \$0.75 per share. Concurrently, the Company purchased from Stëf's treasury 1,000,000 units for \$500,000. Each unit consisted of one common share and 0.87 warrants. Each warrant is exercisable for one common share at \$0.75 per share if exercised by July 31, 1998 and at \$1.00 per share if exercised by July 31, 1999.

The Company recorded its initial investment in Stëf based on the carrying value of its interest in IHS plus the amount of its additional investment as described above.

In light of a sharp decline in the market trading value of Stëf's shares and continuing operating losses, DRAXIS concluded in 1997 that there had been a permanent impairment in the value of its interest in Stëf and accordingly wrote-off the full carrying value of its investment in Stëf of \$1,282,000.

### *Liquidity and Capital Resources*

1997

Cash and cash equivalents at December 31, 1997, totalled \$20,262,000, a decrease of \$5,566,000 over the balance at December 31, 1996, of \$25,828,000.

Major uses of cash in 1997 included the acquisitions of Spectro-Pharm Inc. (\$9,114,000) and the radiopharmaceutical division of Merck Frosst Canada Inc. (\$11,855,000), the early repayment of debt incurred in 1997 in connection with the radiopharmaceutical acquisition (\$10,000,000), investment in net working capital (\$2,951,000) and the funding of operating losses. Major sources of cash in 1997 included proceeds from the *Anipryl*® licensing agreement (\$21,198,000), debt incurred in conjunction with the radiopharmaceutical acquisition (\$13,977,000) and the exercise of warrants (\$3,847,000) and options (\$1,554,000).

In addition to its cash and cash equivalent holdings at December 31, 1996, DRAXIS held approximately 2.7% of the issued and outstanding common shares of Bone Care International, Inc. with a carrying value of \$691,000 and a market value at December 31, 1997 of \$3,320,000. In connection with a proposed public financing by Bone Care International Inc., the Company has entered into a lock-up agreement with Bone Care International Inc.'s underwriters pursuant to which the Company has agreed not to dispose of its common shares of Bone Care International Inc. for 90 days following the date of the final prospectus for the proposed public financing.

As at December 31, 1997, the Company had debt of \$3,977,000, which represented the aggregate net present value of two unsecured non-interest bearing notes held by Merck Frosst Canada Inc.

## Management's Discussion and Analysis of Financial Condition and Results of Operations *continued*

**1996** Cash and cash equivalents at December 31, 1996 were \$25,828,000, an increase of \$9,222,000 over the balance at December 31, 1995, of \$16,606,000. The increase in cash during the year is attributable to the net proceeds from the common share issuance and the proceeds from the sale of the Company's remaining interest in DUSA partially offset by cash consumed in operations after changes in working capital of \$6,690,000 and cash consumed in investing activities including \$1,139,000 in license milestone payments.

In addition to its cash and cash equivalent holdings, at December 31, 1996, DRAXIS held approximately 2.7% of the issued and outstanding common shares of Bone Care International, Inc. with a carrying value of \$691,000 and a market value at December 31, 1996, of \$1,176,000.

**1995** The Company's cash and working capital at December 31, 1995 were \$16,600,000 and \$16,400,000, respectively, compared to \$11,700,000 and \$12,500,000, respectively, in 1994.

Operations generated a positive cash flow of \$2,267,000, down \$4,028,000 from the previous year as a result of the following: lower margins on sales of *Novo-Selegiline* in comparison to sales of *Eldepryl*<sup>®</sup>; non-recurring costs associated with the launch of *Kerasal*<sup>®</sup> into the United States; and non-recurring costs at IHS associated with the start up of the joint venture and the subsequent repositioning and relaunch of its product line.

Cash flow decreases were partially offset by the following: increased profitability on increased sales of *Permax*<sup>®</sup> and decreased losses within the dermatological division. The major capital outlay the Company incurred in 1995 was the second payment of \$1,000,000 for the acquisition of *Permax*<sup>®</sup> from Eli Lilly Canada Inc. The Company also acquired the Canadian rights to Ipriflavone; a drug indicated for the treatment of osteoporosis, from Somerset for \$141,000.

### *Significant Differences Between Canadian and United States GAAP*

DRAXIS, as a Canadian company, follows Canadian generally accepted accounting principals ("GAAP") in reporting its financial results. The differences in the reported results that would have resulted from using United States as opposed to Canadian GAAP are summarized in Note 20 to the 1997 Consolidated Financial Statements.

### *Year 2000 Compliance*

The Company has undertaken a detailed review of its potential exposure to Year 2000 systems issues. In general, DRAXIS' exposure in this area is limited as a result of the limited reliance placed on information technology by the Company's core business practices and the predominance of Year 2000 compliant software systems in use at the Company.

After reasonable inquiry with its major customers and suppliers, the Company has concluded that it is not exposed to any major Year 2000 systems risks from this source.

As described under "Outlook-Acquisition", DRAXIS has entered into a non-binding memorandum of agreement in connection with the possible acquisition of a pharmaceutical manufacturing facility. This facility has a substantial installed base of computerized financial information and production systems. Based on its due diligence investigation of this proposed acquisition, the Company believes that the facility has exposure to Year 2000 systems issues and is developing appropriate remedial plans which would be implemented in the event that DRAXIS is successful in acquiring the facility. A number of alternative solutions are under review and a provision for the estimated costs of this plan has been included in the Company's acquisition business case analysis.

### *Outlook*

In general, management expects a material improvement in DRAXIS' financial results in 1998 relative to 1997. 1998 revenues will increase over 1997 as a result of a full year's sales of Draximage, increased sales of SpectroPharm Dermatology in Canada and the United States, where its lead product was launched early in 1998, and increasing revenues arising from the alliance with Pfizer Inc.

## Management's Discussion and Analysis of Financial Condition and Results of Operations continued

On January 30, 1998, the Company reported on the status of its major research and development initiatives and announced its intention to increase its research and development spending in 1998 by 40% to approximately \$3,500,000, before applicable tax credits. A substantial portion of the Company's 1998 research and development budget will be directed towards Draximage and the development of its pipeline of radiopharmaceutical imaging products.

The transfer of marketing and selling functions with respect to *Anipryl*® to Pfizer Inc. will result in a significant reduction in ongoing operating expenses – provisions for this restructuring were taken in the fourth quarter of 1997. Ongoing *Anipryl*® revenues from royalties, milestones and the supply agreement will be more directly reflected in earnings going forward.

It is anticipated that 1998 operating results will show improvement over 1997 as a result of increased product revenues and lower operating expenses.

Depreciation and amortization expense will decrease significantly in 1998 relative to 1997 as a result of the 1997 write-off of the Company's carrying values of *Anipryl*® and liposome research.

Interest income is expected to exceed interest expense in 1998 due to higher average cash balances and reduced financial expense following the early repayment of a substantial portion of the Company's debt in December 1997.

The Company's net income will be enhanced by US\$10,000,000 (pre-tax) following FDA approval of *Anipryl*®'s cognitive dysfunction supplementary claim and by other milestone payments as regulatory approval of *Anipryl*® in specified countries is received.

### *DRAXIS Pharmaceutica*

The expected decline in 1998 of DRAXIS Pharmaceutica's sales of *Eldepryl*® and *Novo-Selegiline* should be partially offset by continued sales growth of *Permax*®. This division is awaiting regulatory approval of *Alertec*® and is planning its launch for the second half of 1998.

The Company has entered into discussions with Eli Lilly Canada Inc. regarding the extension of the agreement for the Canadian marketing and distribution rights to *Permax*® which expires on December 31, 1998.

In 1998, research and development activities in DRAXIS Pharmaceutica will be focused on obtaining HPB approval for *Alertec*® and the preparation and submission of HPB filings for one-alpha D<sub>2</sub> and compounds in-licensed from Mylan Laboratories Inc., including paclitaxel.

The Company expects to have sufficient information from Mylan Laboratories Inc. to complete a Canadian filing for paclitaxel in the second quarter of 1998. Regulatory approval is expected to take at least 18 months from filing. There is no assurance that the Canadian regulatory authorities will accept the generic equivalence of this form of paclitaxel with the branded version of the drug.

### *SpectroPharm Dermatology*

Sales of SpectroPharm Dermatology in Canada are expected to show continued steady growth in 1998. The entry into the United States is expected to show positive results commencing in the second quarter of 1998.

### *Draximage*

Draximage sales and earnings are expected to remain stable while additional manufacturing capacity is being developed. Plans for new facilities development are expected to be completed in the second quarter of 1998 with anticipated production coming on line in the second half of 1999.

### *Veterinary*

The outlook for DRAXIS' veterinary business is dependent on the degree of success realized by Pfizer Inc. in marketing *Anipryl*®. This effort will be enhanced upon receipt of FDA approval of the cognitive dysfunction supplementary claim which was filed in September 1997.

No significant competition from products approved for veterinary or human use has been experienced to date in Canada. *Anipryl*® is protected by patents in Canada, the United States and other jurisdictions.

## Management's Discussion and Analysis of Financial Condition and Results of Operations *continued*

### *Acquisition*

On March 16, 1998, DRAXIS announced that it had entered into a non-binding memorandum of agreement for the acquisition of a pharmaceutical manufacturing facility.

The 238,000 ft<sup>2</sup> facility is a world-class pharmaceutical plant equipped to manufacture a variety of dosage forms including tablets, liquids, small volume parenterals (injectables), creams, ointments and sterile solutions. It is intended that the facility will become the permanent site for Draximage and assume manufacturing responsibilities, over time, for the SpectroPharm Dermatology line of products and *Anipryl*<sup>®</sup>. In addition, DRAXIS will actively pursue additional third party manufacturing opportunities to complement those already serviced by the facility.

Should the Company be successful in this proposed acquisition, the Company's revenue base will be supplemented with third party pharmaceutical manufacturing revenues. The impact on 1998 EBITDA is expected to be neutral while 1998 net income will be negatively affected due to increased depreciation and financing costs. The acquisition is expected to contribute positively to earnings commencing in late 1999 following transition of the Company's manufacturing requirements to the facility.

### *Liquidity and Capital Resources*

Consolidated operating cash flow is expected to improve in 1998 although the degree of positive results will be dependent on the level of success realized by Pfizer Inc. with *Anipryl*<sup>®</sup> and the success of *SpectroDerm*<sup>®</sup> in the United States market.

The sources of the Company's liquidity as at December 31, 1997 were holdings of cash and cash equivalents aggregating \$20,282,000 and its interest in Bone Care International, Inc. which, at year-end, had a market trading value of \$3,320,000.

Following FDA approval of *Anipryl*<sup>®</sup>'s cognitive dysfunction supplementary claim, the Company will receive a US\$10,000,000 milestone payment from Pfizer Inc. Additional milestone payments aggregating US\$16,000,000 will become payable following specified extra-jurisdictional regulatory approvals for *Anipryl*<sup>®</sup>.

Excluding the impact of the proposed manufacturing acquisition, the Company's existing liquid holdings are expected to be sufficient to fund current operations and their associated capital requirements in 1998. Expenditures associated with the proposed acquisition and the possible renewal of the Canadian marketing and distribution rights to *Permax*<sup>®</sup> would be funded by a combination of external financing arrangements and DRAXIS' existing cash resources.

The Company follows a policy of investing its surplus cash resources in high quality, liquid, short term commercial paper and government treasury bills. There are no restrictions on the flow of these funds nor have any of these funds been committed in any way at this time, except as stated.



*Except for historical information, the foregoing contains certain forward-looking statements that involve risk and uncertainties, which may cause actual results to differ materially from the statements made. Such factors include, but are not limited to, changing market conditions, clinical trial results, the establishment of new corporate alliances, the impact of competitive products and pricing, the timely development, regulatory approval and market acceptance of the Company's products, and other risks detailed from time-to-time in the Company's filings with the US Securities and Exchange Commission and Canadian securities authorities.*

## Management's Responsibility for Consolidated Financial Statements

The accompanying consolidated financial statements of DRAXIS Health Inc. and its affiliated companies and all information in the Annual Report are the responsibility of management and have been approved by the Board of Directors. The financial statements necessarily include some amounts that are based on management's best estimates, which have been made using careful judgement.

The financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Financial and operating data elsewhere in the Annual Report are consistent with the information contained in the financial statements.

In fulfilling their responsibilities, management of DRAXIS Health Inc. and its affiliated companies have developed and continue to maintain systems of internal accounting controls including written policies and procedures and segregation of duties and responsibilities.

Although no cost-effective system of internal controls will prevent or detect all errors and irregularities, these systems are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use, transactions are properly recorded, and the financial records are reliable for preparing the financial statements.

The Board of Directors carries out its responsibility for the financial statements in this Annual Report principally through its Audit Committee, consisting of a majority of outside directors. The Audit Committee meets regularly with management and the external auditors to discuss the results of audit examinations with respect to the adequacy of internal accounting controls and to review and discuss the financial statements and financial reporting matters.

The financial statements have been audited by Deloitte & Touche, Chartered Accountants, who have full access to the Audit Committee.



Martin Barkin, MD, FRCSC  
President and Chief Executive Officer



Jim Garner, CA  
Vice President Finance and Chief Financial Officer  
Mississauga, Ontario  
February 17, 1998


## Auditors' Report

T o   t h e   S h a r e h o l d e r s   o f  
D R A X I S   H e a l t h   I n c .

We have audited the consolidated balance sheets of DRAXIS Health Inc. as at December 31, 1997 and 1996 and the consolidated statements of operations and (deficit) retained earnings and cash flows for each of the years in the three year period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1997 and 1996 and the results of its operations and cash flows for each of the years in the three year period ended December 31, 1997 in accordance with generally accepted accounting principles.

The signature of Deloitte & Touche is written in a cursive, handwritten style.

Chartered Accountants  
Toronto, Ontario  
February 17, 1998

# Consolidated Balance Sheets

D R A X I S Health Inc.

(in thousands of Canadian dollars  
except share related data)

December 31,	1997	1996
<b>Assets</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 20,262	\$ 25,828
Accounts receivable (Note 4)	6,370	2,397
Income taxes recoverable	219	877
Inventory	3,580	1,909
Prepaid expenses	903	442
	31,334	31,453
<b>Long-term investments</b> (Note 5)	691	2,123
<b>Fixed assets</b> (Note 6)	1,776	737
<b>Goodwill</b> (Net of accumulated amortization: 1997 – \$943; 1996 – \$1,011)	10,494	2,196
<b>Patents, licenses and other deferred charges</b> (Note 7)	11,577	30,694
<b>Deferred income taxes</b> (Note 8)	3,206	336
	\$ 59,078	\$ 67,539
<b>Liabilities</b>		
<b>Current</b>		
Accounts payable and accrued charges	\$ 6,273	\$ 3,709
<b>Long-term debt</b> (Note 9)	3,977	-
	10,250	3,709
<b>Shareholders' Equity</b>		
Common stock; unlimited shares authorized, issued and outstanding: 1997 – 31,035,861; 1996 – 29,263,602 shares (Note 10)	58,214	52,813
Preferred stock; unlimited shares authorized, none outstanding	-	-
Employee participation shares; 2,000,000 shares authorized, issued and outstanding: 1997 – 1,274,500; 1996 – 1,319,000	382	396
Less: loans receivable	(382)	(396)
Warrants (Note 10)	520	-
Contributed surplus	9,701	9,701
(Deficit) retained earnings	(19,607)	1,316
	48,828	63,830
	\$ 59,078	\$ 67,539

See the accompanying notes to the Consolidated Financial Statements

Approved by the board



Director



Director

# Consolidated Statements of Operations and (Deficit) Retained Earnings

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

Years ended December 31,	1997	1996	1995
<i>Revenues</i>			
DRAXIS Pharmaceutica	\$ 10,896	\$ 12,956	\$ 15,180
SpectroPharm Dermatology	5,319	864	254
Draximage	3,123	-	-
Veterinary	3,952	280	-
	<b>23,290</b>	14,100	15,434
<i>Expenses</i>			
Cost of sales	7,535	3,109	3,210
Selling, general and administration	19,781	15,036	10,118
Research and development	2,271	1,444	1,937
Investment tax credits on research and development	(280)	(296)	(484)
	<b>29,307</b>	19,293	14,781
(Loss) income from operations before depreciation and amortization	<b>(6,017)</b>	(5,193)	653
Depreciation and amortization	5,518	1,695	1,285
<b>Loss from operations</b>	<b>(11,535)</b>	(6,888)	(632)
<b>Financial</b>			
Interest income	654	1,502	1,197
Financing expense	(1,092)	-	-
	<b>(438)</b>	1,502	1,197
<b>Other (expense) income</b> (Note 11)	<b>(9,315)</b>	6,111	5,449
<b>(Loss) income before income taxes and equity share of loss of affiliated companies</b>	<b>(21,288)</b>	725	6,014
<b>Income taxes</b> (Note 12)			
Current	120	1,121	1,335
Deferred	(713)	(1,439)	729
	<b>(593)</b>	(318)	2,064
<b>(Loss) income before equity share of loss of affiliated companies</b>	<b>(20,695)</b>	1,043	3,950
Equity share of loss of affiliated companies (Note 13)	(228)	(1,209)	(1,533)
<b>Net (loss) income</b>	<b>(20,923)</b>	(166)	2,417
<b>(Deficit) retained earnings, beginning of year</b>	<b>1,316</b>	1,482	(935)
<b>(Deficit) retained earnings, end of year</b>	<b>\$ (19,607)</b>	\$ 1,316	\$ 1,482
<b>Net (loss) income per share</b> (Note 14)	<b>\$ (0.70)</b>	\$ (0.01)	\$ 0.12
<b>Weighted average number of shares outstanding</b>	<b>29,695,743</b>	22,545,890	20,058,062

See the accompanying notes to the Consolidated Financial Statements

# Consolidated Statements of Cash Flows

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

Years ended December 31,	1997	1996	1995
<b>Cash flows (used in) from operating activities (Note 19)</b>	<b>\$ (11,478)</b>	<b>\$ (6,690)</b>	<b>\$ 2,267</b>
<i>Cash flows (used in) from investing activities</i>			
Proceeds from sale of product rights, net of related costs	18,336	-	-
Acquisition of fixed assets	(446)	(245)	(219)
Acquisitions (net of cash acquired)	(20,869)	(23,811)	-
Issue of warrants	(520)	-	-
(Increase) decrease in other deferred charges	(277)	(28)	8
Advances to affiliated companies	(78)	(1,406)	-
Proceeds from sales of shares and options of DUSA Pharmaceuticals, Inc.	-	9,323	3,067
Acquisition of subsidiary and affiliated companies	-	(1,040)	(428)
License milestone payments	-	(1,139)	(1,000)
<b>Net cash flows (used in) from investing activities</b>	<b>(3,854)</b>	<b>(18,346)</b>	<b>1,428</b>
<i>Cash flows from (used in) financing activities</i>			
Exercise of warrants	3,847	-	-
Other issuances of shares	1,554	899	274
Issue of warrants	520	-	-
Proceeds from long-term debt	13,845	-	-
Repayment of long-term debt	(10,000)	-	-
Shares issued on the acquisition of subsidiaries	-	21,686	-
Common share offering, net of related expenses	-	11,562	-
Other long-term receivables	-	111	946
<b>Net cash flows from (used in) financing activities</b>	<b>9,766</b>	<b>34,258</b>	<b>1,220</b>
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>(5,566)</b>	<b>9,222</b>	<b>4,915</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>25,828</b>	<b>16,606</b>	<b>11,691</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 20,262</b>	<b>\$ 25,828</b>	<b>\$ 16,606</b>

Cash and cash equivalents comprise cash, commercial paper and treasury bills

See the accompanying notes to the Consolidated Financial Statements

# Notes to the Consolidated Balance Sheets

(December 31, 1997 and 1996)

D R A X I S   H e a l t h   I n c.

(in thousands of Canadian dollars  
except share related data)

## 1. Summary of Significant Accounting Policies

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada. The financial statements differ in certain respects from United States generally accepted accounting principles, as described in Note 20.

### *Principles of Consolidation*

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries.

### *Accounting for Long-term Investments*

Prior to November 27, 1996, the Company's investment in Deprenyl Animal Health, Inc., a company incorporated in the United States to engage in the research, development and marketing of pharmaceutical products for veterinary prescriptive applications, was accounted for using the equity method. Effective November 27, 1996, the Company acquired the remaining outstanding shares of Deprenyl Animal Health, Inc.

The Company's investment in Stéf International Corporation, a network marketing company which distributes nutritional and personal care products, is accounted for using the equity method. During 1997 the carrying value of this investment was written-off.

The Company's investment in DUSA Pharmaceuticals, Inc. was accounted for using the equity method until December 14, 1995, at which time DUSA Pharmaceuticals, Inc. completed the sale of additional common stock in a public offering. The Company incurred a dilution of its investment from 20.0% to 12.8%. The Company's investment in DUSA Pharmaceuticals, Inc. was recorded at cost after December 14, 1995. On March 11, 1996, the Company disposed of its remaining investment.

The Company's investment in Bone Care International, Inc. is recorded at cost.

On an ongoing basis the Company reviews the carrying value of its investments. Any, other than temporary, impairment in the carrying value is charged to earnings in the year incurred.

### *Goodwill*

Goodwill is recorded as an asset and is amortized on a straight-line basis over ten years.

On an ongoing basis, management reviews the valuation and amortization of goodwill, including any events and circumstances which may have impaired fair value. The amount of goodwill impairment, if any, is determined by assessing recoverability based on expected, discounted, future cash flows using a discount rate reflecting the Company's cost of capital. Any, other than temporary, impairment in the carrying value is charged to earnings in the year incurred.

### *Inventory*

Inventory is valued at the lower of cost and net realizable value and is determined on a first-in, first-out basis.

### *Fixed Assets*

Fixed assets are recorded at cost. The Company provides for depreciation using the following methods and applying rates estimated to amortize the cost over the useful life of the assets:

Computer equipment	30% diminishing balance
Laboratory equipment	20% diminishing balance
Furniture and equipment	20% diminishing balance
Leasehold improvements	straight-line over 5 years

# Notes to the Consolidated Financial Statements *continued*

(December 31, 1997 and 1996)

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

## *Patents, Licenses and Other Deferred Charges*

Patents and trademarks are recorded at cost and amortized on a straight-line basis over 10 years.

Licenses are recorded at cost and consist of licenses to market certain regulatory approved pharmaceutical products in defined territories. The Company provides for amortization of licenses on the straight-line basis over the minimum term of the license agreement which, in the case of the Eldepryl® license is 15 years, Permax® 5 years and Anipryl® 10 years. This policy was changed during 1996, from that of the previous years, whereby amortization of licenses was provided for on the basis of actual sales during the period as a percentage of total estimated sales over the minimum term of the license agreement. As the effect of the change in prior periods is not significant, the prior years' figures have not been restated.

Purchased research and development costs, which relate to acquired research and development costs, are recorded at cost and amortized on a straight-line basis over 10 years.

Deferred financing costs, relating to the costs associated with the issuance of warrants in connection with debt financing, are recorded at cost and are amortized on a straight-line basis over the 3 year term of the warrants.

The cost of the right to technical assistance is amortized on a straight-line basis over the minimum term of the agreement which is 15 years.

## *Research and Development Costs*

Research and product development costs incurred by the Company, including the cost of licenses for products under development, net of any government assistance and investment tax credits, are charged to earnings during the period.

## *Foreign Currency Translation*

Monetary assets and liabilities of integrated foreign subsidiaries are translated into Canadian dollars at the exchange rates in effect at the balance sheet date. Non-monetary items are translated at historical exchange rates. Revenue and expense items are translated at average exchange rates during the year. Exchange gains or losses arising on translation are included in the determination of net income for the year, except for long-term monetary assets and liabilities which are deferred and amortized over the remaining lives of the related items on a straight-line basis.

## *Use of Estimates*

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenses for the year then ended. Actual results may differ from such estimates.

## *Comparative Information*

The Company has reclassified the presentation of certain prior years' information to conform with the current presentation format.

## 2. Acquisitions

### *a) Draximage Inc.*

On July 1, 1997, the Company acquired the assets and business of the radiopharmaceutical division of Merck Frosst Canada Inc. and continued operations of this business through the Company's wholly-owned subsidiary, Draximage Inc.

# Notes to the Consolidated Financial Statements continued

(December 31, 1997 and 1996)

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

The acquisition was accounted for using the purchase method as follows:

<i>Assets</i>	
Purchased research and development costs	\$ 6,289
Patents and trademarks	3,103
Fixed assets	869
Goodwill	1,594
Total acquisition cost	\$ 11,855
<i>Consideration</i>	
Cash	\$ 8,010
Notes payable (Note 9)	3,845
	\$ 11,855

b) *Spectro-Pharm Inc.*

On February 14, 1997, the Company acquired the outstanding shares of Spectro-Pharm Inc. Spectro-Pharm Inc. was amalgamated with the Company on October 1, 1997.

The transaction was accounted for using the purchase method, as follows:

<i>Assets</i>	
Cash and marketable securities	\$ 100
Accounts receivable	338
Inventory	645
Fixed assets	23
Other	16
Goodwill	9,043
	10,165
<i>Liabilities</i>	
Accounts payable	1,051
Net assets acquired	\$ 9,114
<i>Consideration</i>	
Cash	\$ 9,114
	\$ 9,114

c) *Deprenyl Animal Health, Inc.*

Prior to November 27, 1996, the Company owned approximately 44% of the outstanding common shares of Deprenyl Animal Health, Inc. ("DAHI"). Effective November 27, 1996, the Company acquired the remaining outstanding shares of DAHI through a share exchange plan which provided for the mandatory exchange of each share of DAHI common stock for 1.35 shares of the Company's common stock, or 5,729,701 shares of common stock in the aggregate. The investment in DAHI was accounted for using the equity method prior to November 27, 1996 and has been consolidated subsequent thereto.

# Notes to the Consolidated Financial Statements *continued*

(December 31, 1997 and 1996)

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

The acquisition was accounted for using the purchase method, as follows:

<i>Assets</i>	
Cash	\$ 503
Prepaid expenses	8
Inventory	393
Fixed assets	91
Patents and trademarks	27,137
	28,132
<i>Liabilities</i>	
Accounts payable	818
Notes payable	3,466
	4,284
Net assets acquired	23,848
Equity position at date of acquisition	(446)
Total acquisition cost	\$ 23,402
<i>Consideration</i>	
Cash	\$ 1
Common shares	21,486
Acquisition costs	1,915
	\$ 23,402

d) *Tican Pharmaceuticals Ltd.*

On July 25, 1996, the Company acquired all of the outstanding shares of Tican Pharmaceuticals Ltd. in exchange for cash and 44,944 common shares. Tican Pharmaceuticals Ltd. was amalgamated with the Company on January 1, 1997.

The transaction was accounted for using the purchase method, as follows:

<i>Assets</i>	
Cash	\$ 108
Accounts receivable	73
Income taxes recoverable	11
Inventory	108
Fixed assets	17
Goodwill	800
	1,117
<i>Liabilities</i>	
Accounts payable	97
Net assets acquired	\$ 1,020
<i>Consideration</i>	
Cash	\$ 820
Common shares	200
	\$ 1,020

# Notes to the Consolidated Financial Statements continued

(December 31, 1997 and 1996)

D R A X I S Health Inc.

(in thousands of Canadian dollars  
except share related data)

## 3. Anipryl® License and Related Agreements

In December 1997, the Company entered into a global alliance with Pfizer Inc. whereby Pfizer Inc. assumed the worldwide marketing and selling responsibilities for Anipryl® as part of a comprehensive four part arrangement, which included:

*License Agreement* which provides for payments of up to US\$41,090 as follows: US\$15,090 was received in 1997 for the disposition of the Company's right title and interest in the Canadian and United States Cushing's disease registrations and the Canadian cognitive dysfunction syndrome registration, US\$10,000 upon receipt of FDA approval of the cognitive dysfunction supplementary claim and up to an additional US\$16,000 upon receipt of regulatory approvals for Anipryl® in specified countries.

*Royalty Agreement* which provides for royalties based on Pfizer Inc.'s worldwide sales of Anipryl®.

*Supply Agreement* which provides for the Company to supply Anipryl® to Pfizer Inc.

*R&D Agreement* which provides for a research collaboration between the Company and Pfizer Inc. with respect to Anipryl®.

## 4. Accounts Receivable

	1997	1996
Accounts receivable – trade	\$ 5,727	\$ 1,354
Interest and other receivables	553	881
Stef International Corporation	-	64
Loans to officers	90	98
	\$ 6,370	\$ 2,397

The loans to officers are non-interest bearing.

## 5. Long-Term Investments

	1997	1996
<b>Bone Care International, Inc.</b> (quoted market value: 1997 – \$3,320 and 1996 – \$1,176)	\$ 691	\$ 691
<b>Stef International Corporation</b>		
Investment in common shares (quoted market value: 1997 – \$200 and 1996 – \$1,600)	958	958
Note receivable and advances	806	728
Equity share of losses	(482)	(254)
Write-off of investment (Note 11)	(1,282)	-
	-	1,432
	\$ 691	\$ 2,123

The Company's interest in Stef International Corporation is comprised of 4,000,000 common shares, a note receivable for \$728 and non-interest bearing advances of \$78. The note bears interest at bank prime rate plus 1% per annum and is payable quarterly with principal due on August 6, 2001. The note receivable may be converted at the option of the Company into common shares of Stef at \$0.75 per share. The Company holds 866,667 warrants, each exercisable for one common share at \$0.75 per share if exercised by July 31, 1998 and at \$1.00 per share if exercised by July 31, 1999. During 1997, the Company wrote-off its investment in Stef International Corporation.

# Notes to the Consolidated Financial Statements *continued*

(December 31, 1997 and 1996)

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

## 6. Fixed Assets

	1997	1996
Computer equipment	\$ 780	\$ 602
Laboratory equipment	1,141	223
Furniture and fixtures	847	610
Leasehold improvements	58	53
	2,826	1,488
Accumulated depreciation and amortization	(1,050)	(751)
	\$ 1,776	\$ 737

## 7. Patents, Licenses and Other Deferred Charges

	1997		
	Cost	Accumulated Amortization	Net Book Value
Licenses			
Eldepryl®	\$ 1,330	\$ 870	\$ 460
Permax®	3,500	2,551	949
Patents and trademarks			
Draximage	3,103	156	2,947
Purchased research and development costs	6,289	314	5,975
Deferred financing costs	520	72	448
Technical assistance	1,800	1,080	720
Other	78	-	78
	\$ 16,620	\$ 5,043	\$ 11,577

	1996		
	Cost	Accumulated Amortization	Net Book Value
Licenses			
Eldepryl®	\$ 1,330	\$ 794	\$ 536
Permax®	3,500	1,764	1,736
Anipryl®	639	64	575
Patents and trademarks			
DAHI	27,137	220	26,917
Other	90	-	90
Technical assistance	1,800	960	840
	\$ 34,496	\$ 3,802	\$ 30,694

Amortization of patents, licenses and other deferred charges was \$4,075, \$1,268 and \$924 for the years ended December 31, 1997, 1996 and 1995, respectively.

# Notes to the Consolidated Financial Statements continued

(December 31, 1997 and 1996)

**DRAXIS Health Inc.**

(in thousands of Canadian dollars  
except share related data)

## 8. Deferred Income Taxes

Deferred income taxes reflect the net tax effects of timing differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts applicable for income tax purposes. Significant components of the Company's deferred tax assets are as follows:

	1997	1996
Loss and investment tax credit carryforwards	\$ 2,014	\$ -
Licenses and other deferred charges	811	298
Other	381	38
	<b>\$ 3,206</b>	<b>\$ 336</b>

## 9. Long-Term Debt

	1997	1996
Notes payable to Merck Frosst Canada Inc., unsecured and non-interest bearing, \$3,000 due in 1999 and \$1,500 due in 2000. These obligations have been recorded at their net present value based on a discount rate of 7%.	\$ 3,977	\$ -
	<b>\$ 3,977</b>	<b>\$ -</b>

Interest expense on the notes payable totalled \$132 for the year ended December 31, 1997. During 1997 the Company incurred additional interest expense of \$305 related to \$10,000 of borrowings incurred in connection with the acquisition of the radiopharmaceutical division of Merck Frosst Canada Inc. These borrowings were repaid in December 1997.

The fair value of the long-term debt is considered to be equivalent to its carrying value based upon consideration of borrowings with similar credit ratings and maturities.

## 10. Capital Stock

	1997		1996	
	Number of Shares	Dollars	Number of Shares	Dollars
<i>Common stock</i>				
Balance at beginning of the year	29,263,602	\$ 52,813	20,126,718	\$ 18,666
Issued during the year	1,772,259	5,401	9,136,884	34,147
Balance at end of the year	31,035,861	\$ 58,214	29,263,602	\$ 52,813
<i>Issued during the year</i>				
Exercise of warrants	1,176,470	\$ 3,847	-	\$ -
Exercise of options	588,343	1,548	349,226	878
Exercise of participation shares	7,446	6	10,046	7
Treasury common share offering	-	-	3,000,000	11,562
Shares issued on acquisition of Deprenyl Animal Health, Inc.	-	-	5,729,701	21,486
Shares issued on acquisition of Tican Pharmaceuticals Ltd.	-	-	44,944	200
Shares issued in lieu of salary	-	-	2,967	14
	<b>1,772,259</b>	<b>\$ 5,401</b>	<b>9,136,884</b>	<b>\$ 34,147</b>

## Notes to the Consolidated Financial Statements *continued*

(December 31, 1997 and 1996)

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

### *Warrants*

#### **Novopharm Limited**

In December, 1997 Novopharm Limited exercised warrants to purchase 1,176,470 shares of the Company at an exercise price of \$3.27 per warrant for aggregate proceeds to the Company of \$3,847.

On April 19, 1995 the Company issued 500,000 warrants to Novopharm Limited each of which are exercisable to April 18, 2000 to purchase one common share of the Company at \$2.09. The Company issued the warrants to Novopharm Limited in exchange for Novopharm Limited's grant of a six month extension of a profit sharing agreement between the two companies.

#### **Underwriters**

In connection with the completion of DRAXIS' public offering in April 1996, a non-assignable warrant was issued to the Company's underwriters. The warrant is exercisable for 300,000 DRAXIS shares at \$4.25 per share and expires on April 22, 1998.

#### **Other**

In connection with borrowings incurred related to the acquisition of the radiopharmaceutical division of Merck Frosst Canada Inc., the Company issued to a financial institution a non-assignable warrant to purchase 750,000 shares at \$3.70 per share on or before July 31, 2000. Pursuant to the terms of this warrant, the number of exercisable shares was reduced to 600,000 as a result of the early repayment of the related borrowings in 1997.

Included as a component of shareholders' equity and deferred financing charges is \$650, which represents the cost of the above warrant. The fair value of the warrant was estimated at the date of issue using the Black-Scholes option-pricing model with the following assumptions: dividend yield of 0%, expected volatility of 40%, risk-free interest rate of 5.5%, and expected life of three years.

In connection with the 1996 DAHI share exchange transaction, a warrant to purchase DAHI common shares was exchanged for a warrant to purchase 270,000 common shares of the Company at US\$2.22 per share. Such warrant vests, if at all, and becomes exercisable only if DAHI has net profits, as defined, within seven years of its original issue date. If DAHI has such net profits, the warrant shall be exercisable for a period of three years following the fiscal year end in which such net profits occurred. It has not yet been established whether the conditions for vesting and exercisability of this warrant were met as at December 31, 1997.

In aggregate, there were 1,670,000, 2,246,470 and 2,676,470 warrants outstanding at December 31, 1997, 1996 and 1995, respectively.

### *Stock Option Plan*

The Board of Directors has adopted a stock option plan in order to provide an incentive for directors, officers and employees. The plan provides that the Board of Directors may, from time to time, at its discretion, grant to directors, officers and employees, the option to purchase common shares. The Board of Directors will determine the price per common share and the number of common shares which may be allotted to each designated director, officer or employee and all other terms and conditions of the option in accordance with the applicable requirements of any relevant regulatory authority or stock exchange. These options will be exercisable for a period not exceeding ten years from the date of the grant.

On June 16, 1995, the Board of Directors received shareholder approval to set a maximum of 2,500,000 options for issuance under the stock option plan. On November 25, 1996, in connection with the acquisition of Deprenyl Animal Health, Inc. through a share exchange plan, the Board of Directors received shareholder approval to increase the maximum for issuance under the stock option plan to 4,500,000 options. Subsequent to the completion of the acquisition of Deprenyl Animal Health, Inc., options to acquire shares of Deprenyl Animal Health, Inc. common stock were exchanged for options to acquire shares of the Company's common stock at an exchange ratio of 1.35 to 1.

# Notes to the Consolidated Financial Statements continued

(December 31, 1997 and 1996)

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

Information pertaining to options for the years ended December 31, 1997, 1996 and 1995 is set forth in the following table:

	1997	1996	1995
Options outstanding, beginning of year	3,127,767	1,693,500	1,828,000
Options assumed – DAHI	-	1,554,493	-
Options granted	242,000	340,000	30,000
Options exercised	(588,343)	(349,226)	(101,949)
Options cancelled or expired unexercised	(10,000)	(111,000)	(62,551)
Options outstanding, end of year	2,771,424	3,127,767	1,693,500
Options exercisable, end of year	1,871,778	2,060,682	1,334,168
Exercise prices per share:			
Exercised during the year	\$0.33 to \$3.11	\$1.75 to \$2.55	\$1.75 to \$2.55
Granted during the year	\$3.00 to \$4.29	\$3.60 to \$4.40	\$2.45 to \$2.63
Assumed during the year	-	\$0.33 to \$4.14	-

## Employee Participation Share Plan

On February 16, 1995, the Company established the Employee Participation Share Plan for the directors, officers and employees of the Company to tie employee compensation more closely to shareholder value. The Employee Participation Share Plan was approved by the shareholders on June 16, 1995. The Board of Directors has provided that it would be a condition to receiving any benefit from the Employee Participation Share Plan that the share price have appreciated at least 25% from the date of issuance of any Participation Shares. The maximum number of Participation Shares issuable pursuant to the Employee Participation Share Plan is 2,000,000.

Vesting takes place over a four year period at the rate of 20%, 20%, 20% and 40% commencing on the first anniversary of the issuance of the Participation Shares and for each of the three years thereafter with the exception of 500,000 Participation Shares held by an officer of the Company which vest at the rate of 10%, 20%, 30% and 40%. Vested Participation Shares are automatically convertible into shares of the Company at the election of the holder, provided that the shares have increased in value since the date of issuance of the vested Participation Shares by the aforementioned 25%. The number of Company shares a Participant will receive when converting Participation Shares is determined by multiplying the number of Participation Shares held by a Participant by a fraction whose numerator is the amount by which the fair market value of a share at the date of conversion exceeds the fair market value of a share as at the date on which the Participation Shares were issued and whose denominator is the fair market value of the shares at the date of conversion.

On February 16, 1995, the Board of Directors of the Company authorized the issuance of 975,000 Series A Participation Shares at a subscription price of \$0.30 each. The average of the daily high and low board lot trading prices on each of the five trading days on the Toronto Stock Exchange immediately preceding the issuance of the Series A Participation Shares was \$2.45.

On December 18, 1995, the Board of Directors of the Company authorized the issuance of 555,000 Series B Participation Shares at a subscription price of \$0.30 each. The average of the daily high and low board lot trading prices on each of the five trading days on the Toronto Stock Exchange immediately preceding the issuance of the Series B Participation Shares was \$2.25.

The shares have been issued for \$0.30 per share and paid for by the employees through the issuance of a limited recourse promissory note and are secured against the shares.

# Notes to the Consolidated Financial Statements *continued*

(December 31, 1997 and 1996)

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

Information pertaining to Employee Participation Shares for the years ended December 31, 1997, 1996 and 1995 is set forth in the following table:

	1997	1996	1995
Participation shares outstanding, beginning of year	1,319,000	1,530,000	-
Participation shares granted	-	-	1,530,000
Participation shares exercised	(21,500)	(23,500)	-
Participation shares cancelled	(23,000)	(187,500)	-
Participation shares outstanding, end of year	1,274,500	1,319,000	1,530,000
Participation shares exercisable, end of year	680,700	257,000	-

## Stock-Based Compensation

United States generally accepted accounting principles require disclosure or recognition of compensation expense related to its stock-based compensation plans. Had compensation cost for stock option plans (including the Employee Participation Share Plan) been determined based upon fair value at the grant date for awards under these plans consistent with the methodology prescribed under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation", the Company's net income (loss) and earnings (loss) per share under US GAAP would have been reduced (increased) by approximately \$754 or \$0.03 per share, (\$568) or (\$0.03) per share and (\$286) or (\$0.01) per share in the years 1997, 1996 and 1995, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grant in 1997, 1996 and 1995; dividend yield of 0%, expected volatility of 50%, risk-free interest rate of 5.5%, and expected lives of an average of five years.

## 11. Other (Expense) Income

	1997	1996	1995
Loss on sale of product rights	\$ (6,756)	\$ -	\$ -
Write-down of goodwill and other intangibles	(1,277)	-	-
Write-off of investment in Stéf International Corporation	(1,282)	-	-
Gain on sale of securities	-	6,111	549
Gain on dilution of investment	-	-	1,833
Gain on sale of option	-	-	3,067
	\$ (9,315)	\$ 6,111	\$ 5,449

## Loss on Sale of Product Rights

In December 1997, the Company entered into a global alliance with Pfizer Inc. with respect to *Anipryl*<sup>®</sup> (Note 3). Pursuant to the terms of the License Agreement with Pfizer Inc., the Company disposed of its right, title and interest in the Canadian and United States Cushing's disease registrations and the Canadian Cognitive Dysfunction Syndrome registration for proceeds of \$21,198 (US\$15,090). Included as costs of the sale, totalling \$27,954, are the net book value of *Anipryl*<sup>®</sup> licenses and other intangibles, and transaction and restructuring costs.

## Write-down of Goodwill and Other Intangibles

The Company concluded that the results of its research into the development of a prescription pharmaceutical based on the liposomal delivery system acquired from Lipopharm Inc. did not meet expectations and consequently development in this area would cease. As a result, the net book value of goodwill associated with Lipopharm Inc. and related intangibles were written off in fiscal 1997.

# Notes to the Consolidated Financial Statements continued

(December 31, 1997 and 1996)

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

## Write-off of Investment in Stëf International Corporation

Since its acquisition in August of 1996, Stëf has incurred continuing operating losses, negative cash flows and a significant decline in quoted market value below the Company's carrying value of this investment. In 1997, the Company determined that the loss in value of this investment was permanent and that a write-off of the investment was required.

## 12. Income Taxes

The major factors giving rise to differences between statutory income tax rates and the Company's consolidated effective income tax rate are set forth in the following table:

	1997	1996	1995
Canadian federal and provincial tax rate	39%	39%	39%
United States federal and state tax rate	34%	34%	34%
Income taxes based on the Canadian and US statutory rates	\$ (1,788)	\$ 268	\$ 2,345
Tax effect of:			
Capital gains	(261)	(945)	(281)
Non-deductible portion of amortization of intangible assets	475	218	104
Write-down of goodwill and write-off of investment	720	-	-
Other permanent differences	261	141	(104)
	\$ (593)	\$ (318)	\$ 2,064

## 13. Equity Share of Loss of Affiliated Companies

	1997	1996	1995
Equity share of loss of:			
Stëf International Corporation	\$ (228)	\$ (254)	\$ -
DUSA Pharmaceuticals, Inc.	-	-	(956)
Deprenyl Animal Health, Inc.	-	(955)	(577)
	\$ (228)	\$ (1,209)	\$ (1,533)

## 14. Earnings per Share

Earnings per share is based on the weighted average number of common shares outstanding (basic) adjusted, to the extent they are dilutive, for outstanding stock options and stock purchase warrants (fully diluted). Basic earnings per share and fully diluted earnings per share are not materially different for the years presented.

# Notes to the Consolidated Financial Statements *continued*

(December 31, 1997 and 1996)

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

## 15. Related Party Transactions

Significant transactions not otherwise disclosed in the accompanying financial statements, were as follows:

	1997	1996	1995
Net contribution from the sales of a product by a company which is a shareholder included in income from operations (total revenues – 1997 – \$5,547; 1996 – \$7,120; 1995 – \$5,942)	\$ 1,598	\$ 2,063	\$ 2,513
Rent paid to a company jointly controlled by a member of the Board of Directors included in selling, general, and administration expenses	169	146	144
Interest received from a significantly controlled investee, prior to acquisition, included in interest income	–	254	334

The aforementioned transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

## 16. Commitments

### *Agreements with Mylan Laboratories Inc.*

On September 24, 1997, the Company and Mylan Laboratories Inc. (“Mylan”) announced an agreement under which the Company would exclusively register, market, sell and distribute certain generic products in Canada. Under the agreement, the first of such generic drugs, upon receipt of formulary approval in Ontario or Québec, would necessitate a payment to Mylan of US\$120. The agreement is for an initial term of seven years from the date of product approval by the Health Protection Branch with automatic one-year renewals at the option of both parties. The Company paid US\$60 upon execution of the agreement.

In January 1997, the Company entered into a supply and distribution agreement with Mylan for the exclusive Canadian rights to market the Mylan formulation of the cancer drug, Paclitaxel. The agreement is for an initial term of five years from the date of product approval by the Health Protection Branch with automatic one-year renewals at the option of both parties.

In accordance with both agreements, a formula was agreed to between the parties providing for the sharing of profits from the marketing and selling of the generic product and Paclitaxel in Canada. Also, beginning with the first commercial sale, the Company is further obligated to meet certain minimum purchase requirements in any given year or the agreement could be terminated at Mylan’s option.

### *Agreements Pertaining to the Acquisition of the Radiopharmaceutical Division of Merck Frosst Canada Inc.*

In connection with the acquisition of the assets and business of the radiopharmaceutical division of Merck Frosst Canada Inc. (“the vendor”) in July 1997 (Note 2), the Company is required to pay to the vendor a retained financial interest calculated as an amount equal to 7.5% of the net sales of new products currently under development. The retained financial interest is payable quarterly for a period which is the greater of 10 years from commercial launch of the new product, or, if a patent has been issued or applied for, the period from commercial launch of the new product until expiry of the patent.

The Company assumed various royalty agreements which require certain fixed payments and variable payments ranging between 5% and 20% of the net sales of new products currently under development for terms ranging between 12 years and the period until expiry of the patents.

In addition, up to \$1,500 may become payable to the vendor based on the receipt of US regulatory approval for certain product rights acquired.

## Notes to the Consolidated Financial Statements *continued*

(December 31, 1997 and 1996)

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

### *Agreement Pertaining to Ipriflavone*

On January 31, 1995, the Company acquired from Somerset Pharmaceuticals Inc. the exclusive Canadian marketing rights to the osteoporosis drug *Ipriflavone*. The Company paid US\$100 upon signing of the agreement and will be required to make payments of US\$200 at the time Somerset Pharmaceuticals Inc. files a New Drug Submission with the Health Protection Branch, Health and Welfare Canada and US\$400 upon issuance of a Notice of compliance on that New Drug Submission by the Health Protection Branch, Health and Welfare Canada. In addition, the Company agreed that in the event that during the twelve months prior to the third anniversary of the launch of *Ipriflavone*, gross sales of *Ipriflavone* exceed \$10,000 the Company would pay to Somerset Pharmaceuticals Inc. an additional amount equal to seven percent of all gross sales above \$10,000 during such twelve-month period.

### *Agreement Pertaining to Alertec®*

During November 1992, the Company entered into a license agreement with Laboratoire L. Lafon for the right to market any product containing the compound *Alertec®* in Canada. The cost of the license consisted of a cash payment of US\$150 and the Company paid an additional US\$150 upon filing a New Drug Submission in June 1993. The Company will be required to make a further cash payment of US\$300 upon receiving Health Protection Branch, Health and Welfare Canada approval to market such products.

### *Agreement Pertaining to Supply of l-deprenyl*

On October 1, 1990 and subsequently amended on July 5, 1995, DAHI entered into an exclusive supply agreement with Chinoin Pharmaceutical and Chemical Works Company Ltd. ("Chinoin") whereby Chinoin has agreed to manufacture and supply the Company's requirements for l-deprenyl in North America. The agreement provides that DAHI will purchase the product from Chinoin for a period of four years, beginning on the effective date of the amendment. In addition, DAHI must pay a royalty of three percent to Chinoin on net sales of *Anipryl®* for a three year period. DAHI has developed the data required to qualify an alternative source of supply for l-selegiline. The agreement ends on the earliest of (i) November 22, 2003, or any extended expiration date agreed to by Chinoin and the United States licensee under a license agreement between them, or (ii) a determination date pursuant to provisions regarding force majeure or certain other events.

### *Other*

The Company has established a long term incentive plan for senior management of Draximage. The terms of the plan provide that, subject to the achievement of certain conditions, the Company will make payments to plan participants in the form of cash and/or DRAXIS common shares, at the Company's option, based on increases in the fair market value of Draximage's equity in excess of DRAXIS' acquisition cost.

The Company is committed under operating leases for buildings requiring minimum annual lease payments of \$173 and \$56 for 1998 and 1999, respectively.

# Notes to the Consolidated Financial Statements *continued*

(December 31, 1997 and 1996)

D R A X ' I S   H e a l t h   I n c .

(in thousands of Canadian dollars  
except share related data)

## 17. Financial Instruments

The fair value of cash, accounts receivable, accounts payable and accrued charges are equivalent to their carrying value because of the short-term maturity of those instruments. The fair value of long-term investments is determined based on quoted market prices. The Company is not party to any significant derivative instruments.

The Company is subject to credit risk through trade receivables, note receivable included in long-term investments and short-term cash investments. Credit risk with respect to trade receivables is limited given the creditworthiness of the counterparties. Exposure to credit risk associated with the note receivable is determined by reviewing the fair value of the Company's total investment, which includes the carrying value of the note receivable. The Company places its temporary excess cash investments in high quality government securities and short-term commercial paper.

The Company is subject to currency risk through its US integrated foreign operations. Changes in the exchange rate may result in a decrease or increase in the foreign exchange gain or loss. The Company does not actively use derivative instruments to reduce its exposure to foreign currency risk.

## 18. Segmented Information

### *Industry Segmentation*

The Company considers that its operations are principally in one segment: the research, development, marketing and sale of pharmaceutical and biotechnology products.

### *Geographic Segmentation*

	1997	1996	1995
<b>Sales</b>			
Canada	\$ 20,895	\$ 13,198	\$ 14,836
United States	2,395	902	598
	\$ 23,290	\$ 14,100	\$ 15,434
<b>(Loss) income from operations</b>			
Canada	\$ (3,994)	\$ (3,766)	\$ 911
United States	(7,541)	(3,122)	(1,543)
	\$ (11,535)	\$ (6,888)	\$ (632)
<b>Identifiable assets</b>			
Canada	\$ 48,025	\$ 38,176	\$ 34,770
United States	11,053	29,363	282
	\$ 59,078	\$ 67,539	\$ 35,052

# Notes to the Consolidated Financial Statements *continued*

(December 31, 1997 and 1996)

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

## 19. Cash Flows from Operating Activities

	1997	1996	1995
Net (loss) income for the year	\$ (20,923)	\$ (166)	\$ 2,417
<b>Non-cash transactions reflected in net (loss) income</b>			
Depreciation and amortization	4,374	1,428	1,051
Amortization of goodwill	1,144	267	234
Deferred income taxes	(2,870)	(1,439)	729
Equity share of net loss of affiliated companies	228	1,209	1,533
Writedown of goodwill, investment and other intangibles	2,560	-	-
Loss on sale of product rights	6,756	-	-
Amortization of deferred financing costs	72	-	-
Interest on long-term debt	132	-	-
Gain on dilution of investment	-	-	(1,833)
Gain on sale of shares and options	-	(6,111)	(3,616)
	(8,527)	(4,812)	515
<b>Changes in current assets and current liabilities impacting cash flows from operations</b>			
Accounts receivable	(3,635)	(838)	321
Inventory	(1,026)	(704)	310
Proceeds from sale of marketable securities	-	109	1,316
Prepaid expenses	(461)	363	150
Accounts payable and accrued charges	1,725	(374)	(237)
Royalties payable	(212)	261	(193)
Income taxes	658	(695)	85
	(2,951)	(1,878)	1,752
<b>Cash flows (used in) from operating activities</b>	\$ (11,478)	\$ (6,690)	\$ 2,267

# Notes to the Consolidated Financial Statements *continued*

(December 31, 1997 and 1996)

D R A X I S Health Inc.

(in thousands of Canadian dollars  
except share related data)

## 20. United States Generally Accepted Accounting Principles

The consolidated financial statements have been prepared in accordance with Canadian GAAP which conforms, in all material respects applicable to the Company, with US GAAP during the years presented except for the following:

	1997	1996	1995
<b>Net (loss) income for the year</b>			
As reported under Canadian GAAP	\$ (20,923)	\$ (166)	\$ 2,417
<b>Adjustments to reported net (loss) income</b>			
Gain on sale of product rights, net	23,813	-	-
Elimination of purchased research and development costs	(6,289)	-	-
Amortization of purchased research and development costs	315	-	-
Amortization of technical assistance costs	120	120	120
Amortization of patents and trademarks	2,435	220	-
Reduction (increase) in income tax expense due to differences in net income from Canadian to US GAAP reconciling items	2,306	(1,165)	1,334
Increase in gain on sale of shares in affiliated company under US GAAP	-	3,930	-
Elimination of patents and trademarks	-	(29,406)	-
Reversal of deferred taxes	-	(697)	-
Elimination of gain on dilution of investment in affiliated companies	-	-	(1,833)
Elimination of gain on sale of option in affiliated company	-	-	(3,067)
	22,700	(26,998)	(3,446)
<b>As adjusted under US GAAP</b>	\$ 1,777	\$ (27,164)	\$ (1,029)
<b>Basic earnings (loss) per share – US GAAP</b>	\$ 0.06	\$ (1.20)	\$ (0.05)
<b>Average common shares and common share equivalents – US GAAP</b>	29,695,743	22,545,890	20,058,062

### Earnings Per Share

Under Canadian GAAP, basic earnings per share is computed using the weighted average number of shares outstanding during each period. For US GAAP, the Company implemented the provisions of SFAS No. 128, "Earnings Per Share" as of December 31, 1997. The Statement replaced the Company's presentation of primary net (loss) earnings per share with a presentation of basic and diluted earnings (loss) per share. Basic earnings (loss) per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. All prior period weighted average and per share information has been restated in accordance with SFAS No. 128. The computation of diluted earnings (loss) per share does not include stock options and warrants with dilutive potential that would have an antidilutive effect on earnings per share.

# Notes to the Consolidated Financial Statements continued

(December 31, 1997 and 1996)

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

## Patents, Licenses and Other Deferred Charges

Amortization of technical assistance costs are payments made to a third-party licensor for technical assistance to be provided to the Company for product development, market penetration and clinical testing of new products.

Under Canadian GAAP these costs are deferred and charged to expense on a straight-line basis beginning in 1989.

Under US GAAP these costs are charged to expense as incurred. During 1988 such costs were charged to expense for US GAAP purposes. Commencing in 1989, amortization of these costs for Canadian GAAP has been added back to pre-tax income for US GAAP reconciliation purposes.

Under Canadian GAAP, the acquisition of DAHI (see Note 2) was accounted for by the purchase method of accounting. The cost of the purchase and amounts assigned to assets acquired and liabilities assumed were determined as of the date of acquisition. The excess of the purchase price over the fair value of the assets acquired of \$29,406 (\$26,468 – Canadian GAAP) was allocated to patents and trademarks.

Under US GAAP, the acquisition would also have been accounted for by the purchase method, however, the cost of the purchase would be calculated at the date of the share exchange agreement. The effect of this difference is that the amount assigned to the patent and trademark for US GAAP is \$29,406. At the date of acquisition, the patented and trademark license had yet to receive regulatory approval for its significant indications and markets. Accordingly, the amount has been charged to expenses.

Under Canadian GAAP, included as a cost of the sale of product rights, is the unamortized patent and trademark cost of \$23,813.

Under US GAAP, the unamortized patent and trademark costs were charged to expenses as at the date of acquisition. As a result of excluding this amount for US GAAP, a gain on the sale of product rights has been recorded.

Under Canadian GAAP, the acquisition of the assets of Draximage Inc., formerly the radiopharmaceutical division of Merck Frosst Canada Inc. (see Note 2), was accounted for by the purchase method of accounting. Included in the amounts assigned to assets acquired is \$6,289 of purchased research and development costs which represent amounts related to the development of products which have yet to receive regulatory approval.

Under US GAAP, the acquisition would also have been accounted for by the purchase method, however, the amount related to the purchased research and development costs would be charged to expenses as at the date of acquisition as no alternative future use has been established.

## Gain on Dilution of Investments in Affiliated Companies

Under Canadian GAAP, an offering that takes the form of an investee's direct sale of its unissued shares, in an amount in excess of the investor's carrying value, is reflected as a gain on dilution in the investor's statement of operations.

Under US GAAP, the additional equity raised by an investee in the development stage is reflected as an equity transaction in the investor's statement of shareholders' equity.

## Gain on Sale of DUSA Option in Affiliated Companies

Under Canadian GAAP, a gain is recognized for the excess of proceeds over the carrying value of the option.

Under US GAAP, a gain on sale of the option reduces the carrying value of the Company's remaining investment in common stock of DUSA, since DUSA is considered to be in the development stage.

\* In process R&D for  
\*\* Also In process R&D for

# Notes to the Consolidated Financial Statements *continued*

(December 31, 1997 and 1996)

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

## Unrealized Investment Gains and Losses

Due to the acquisition of DAHI, the Company reviewed its investment strategy and as a result its investments were reclassified from "held to maturity" to "available for sale." Statement of Financial Accounting Standards ("SFAS") No. 115 requires the Company to record securities which management has classified as available for sale at fair market value and to record unrealized gains and losses on securities available for sale as a separate component of shareholders' equity until realized. As at December 31, 1997, securities available for sale amounted to \$3,137 and the unrealized gains of \$5 would be recognized within shareholders' equity. For Canadian GAAP, investments are recorded at cost and gains and losses are recognized when realized.

Securities available for sale consist of Canadian treasury bills and commercial paper with yields ranging from 3.5% to 3.6% and maturity dates ranging from March 27, 1998 to September 17, 1998.

## Deferred Taxes

Prior to the acquisition of DAHI, the Company established net deferred tax liabilities related to the dilution of its investment in the acquiree. As the Company has acquired DAHI this liability no longer exists. For Canadian GAAP, the reversal of the deferred taxes has been credited against the share of the equity losses from DAHI. For US GAAP, gains on dilution of investments were reflected as an equity transaction and the reversal of deferred taxes has been recorded similarly.

## Research and Development Tax Credits

Under Canadian GAAP, the research and development tax credits are included in loss from operations.

Under US GAAP, the research and development tax credits would have been included in the provision for income taxes. All research and development tax credits relate to activities conducted in Canada.

The effect of this difference is that for the years ended December 31, 1997, 1996 and 1995 loss from operations would increase by \$280, \$296 and \$484 respectively. Accordingly, income tax expense would decrease by these amounts for the respective years.

## Shareholders' Equity

Shareholders' equity determined under US GAAP as at December 31, 1997, 1996, and 1995, would increase (decrease) by \$612, \$(21,453) and \$770 respectively, compared to the amounts determined under Canadian GAAP.

## Consolidated Statements of Changes of Cash Flows

	1997	1996	1995
Net (decrease) increase in cash and cash equivalents under Canadian GAAP	\$ (5,566)	\$ 9,222	\$ 4,915
Net increase (decrease) in cash and cash equivalents (see note below)	20,376	(8,466)	(5,102)
Net increase (decrease) in cash under US GAAP	14,810	756	(187)
Cash and cash equivalents at beginning of the year	2,323	1,567	1,754
Cash and cash equivalents at end of the year	\$ 17,133	\$ 2,323	\$ 1,567

Treasury bills and commercial paper are considered cash equivalents for Canadian GAAP purposes. For US GAAP purposes, only treasury bills and commercial paper with original maturities of three months or less are considered cash equivalents.

# Notes to the Consolidated Financial Statements continued

(December 31, 1997 and 1996)

DRAXIS Health Inc.

(in thousands of Canadian dollars  
except share related data)

## Additional Information Required under US GAAP:

	1997	1996	1995
Income taxes (recovered) paid	\$ (538)	\$ 1,828	\$ 1,250
Interest paid	\$ 305	\$ -	\$ -

## Equity Investments Financial Information

During 1997, the Company wrote-off its investment in Stéf International Inc. Consequently, summarized financial statements of Stéf International Inc. are not presented. Deprenyl Animal Health, Inc. (DAHI) and DUSA Pharmaceuticals, Inc. (DUSA) summarized earnings statement are as follows:

	1995	
	DAHI	DUSA
Interest income	\$ 385	\$ 795
Research and development expenses	\$ 1,921	\$ 4,180
Net loss	\$ 2,501	\$ 4,095

## New Statements of Financial Accounting Standards

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income", which establishes standards for the reporting and display of comprehensive income and its components (revenues, expenses, gains and losses) in a full set of general-purpose financial statements. The Statement requires all items that are required to be recognized under accounting standards as components of comprehensive income be reported separately from the Company's accumulated deficit balance in a financial statement that is displayed with the same prominence as other financial statements. The Statement is effective for the Company's December 31, 1998 financial statements. The Company does not anticipate that the implementation of this Statement will have a material impact on the consolidated financial statements.

In June 1997, the FASB issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information". The Statement establishes standards for the way that a public business enterprise reports information about operating segments in interim financial reports issued to shareholders. It also establishes standards for related disclosures about products and services, geographic areas, and major customers. The Statement is effective for the Company's December 31, 1998 financial statements. The Company does not anticipate that the implementation of this Statement will have a material impact on the consolidated financial statements.

S/E rec:

from 1996: 96 95  
 112 3123  
 34 <23192>  
 111 <926>  
 43 <553>  
 from 1997: 34 20 274  
 96 120  
 111 2306  
 19 <635>  
 612

**Historical Financial Information**

	1997	1996	1995	1994	1993
<i>Operations</i>					
Revenues	\$ 23,290	\$ 14,100	\$ 15,434	\$ 16,243	\$ 15,087
Research and Development Expenses	2,271	1,444	1,937	1,545	2,235
EBITDA <sup>1</sup>	(6,017)	(5,193)	653	4,968	1,386
Net (Loss) Income	(20,923) <sup>2</sup>	(166)	2,417	1,099	(2,079)
<i>Financial Position</i>					
Cash and Cash Equivalents	20,262	25,828	16,606	11,691	12,205
Total Assets	59,078	67,539	35,052	33,062	31,986
Shareholders' Equity	48,828	63,830	29,849	27,159	26,036
<i>Changes in Financial Position</i>					
Operating Cash Flow	(11,478)	(6,690)	2,267	6,295	6,800
<i>Per Common Share</i>					
Net (Loss) Income	(0.70) <sup>2</sup>	(0.01)	0.12	0.06	(0.11)
Shareholders' Equity	1.57	2.18	1.48	1.36	1.31
<i>Share Information</i>					
Number of Shares Outstanding at End of the Year	31,035,861	29,263,602	20,126,718	20,019,297	19,836,274
Weighted Average Number of Shares Outstanding	29,695,743	22,545,890	20,058,062	19,927,427	18,217,063

**Quarterly Financial Results (Unaudited)**

1997 Quarter Ended	March 31	June 30	Sept. 30	Dec. 31	Total
Revenues	\$ 3,350	\$ 5,548	\$ 6,164	\$ 8,228	\$ 23,290
EBITDA <sup>1</sup>	(2,131)	(1,116)	(1,623)	(1,147)	(6,017)
Net Loss	(2,561)	(2,031)	(2,919)	(13,412) <sup>2</sup>	(20,923)
Net Loss per Common Share	(0.09)	(0.07)	(0.10)	(0.45)	(0.70)
1996 Quarter Ended	March 31	June 30	Sept. 30	Dec. 31	Total
Revenues	\$ 3,322	\$ 3,703	\$ 3,334	\$ 3,741	\$ 14,100
EBITDA <sup>1</sup>	(1,589)	(1,070)	(1,711)	(823)	(5,193)
Net (Loss) Income	3,032	(1,166)	(1,538)	(494)	(166)
Net (Loss) Income per Common Share	0.15	(0.06)	(0.07)	(0.02)	(0.01)

<sup>1</sup> Earnings (loss) before depreciation and amortization, financial income (expense), other income (expense), income taxes and equity share of loss of affiliated companies.

<sup>2</sup> Includes non-recurring expenses aggregating \$9,315,000 (see Note 11 to the Consolidated Financial Statements).

## Officers and Directors

**Brian M. King** <sup>1</sup>  
*Director and Chairman*

**James P. Doherty** <sup>2</sup>  
*Director and Vice Chairman*

**Martin Barkin, MD,**  
BScMed, MA, FRCSC  
*Director, President, CEO, COO*

**Leslie L. Dan** <sup>2</sup>  
*Director*

**George Darnell** <sup>2</sup>  
*Director*

**Samuel Sarick** <sup>1,2</sup>  
*Director*

**Stewart D. Saxe** <sup>1</sup>  
*Director*

**Raymond Doré**  
*President, Draximage Inc.*

**Jim A. H. Garner**  
*Vice President Finance and Chief Financial Officer*

**Jacqueline H. R. Le Saux,**  
MBA, LL.B  
*Vice President, Corporate Development and Secretary President, DRAXIS Pharmaceutica and DAHI*

**Roger Mailhot, PhD**  
*Vice President, Scientific and Regulatory Affairs*

**Teri Puccini-Staley**  
*President, SpectroPharm Dermatology*

1. Member of the Compensation Committee

2. Member of the Audit Committee

## Shareholder Information

### Form 20-F

For regulatory purposes in the United States, the Company files an Annual Report on Form 20-F with the Securities and Exchange Commission. A copy may be obtained by any shareholder upon request to the Company.

### Stock Listings

DRAXIS Health Inc. common shares are listed in Canada on The Toronto Stock Exchange (TSE) and in the United States on the National Association of Securities Dealers and Quotations Inc. (NASDAQ).

In 1997 share trading volume on the TSE was 12,409,671 shares or an average of 49,245 shares per trading day. In 1997 shares trading volume on the NASDAQ was 20,360,019 or an average of 80,474 per trading day.

### Transfer Agent and Registrar

Montreal Trust Company of Canada  
Corporate Services Division  
Stock and Bond Transfer Services  
151 Front Street West, 8th Floor  
Toronto, Ontario M5J 2N1  
(416) 981-9500 telephone  
(416) 981-9800 fax

### Shareholder Services

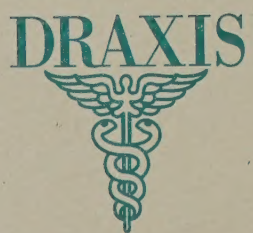
Please direct inquiries to the attention of:  
Investor Relations  
DRAXIS Health Inc.  
6870 Goreway Drive  
Mississauga, Ontario L4V 1P1  
(905) 677-5500 telephone  
(905) 677-5502 fax  
Internet: [www.draxis.com](http://www.draxis.com)

### Corporate Counsel

McCarthy Tétrault  
Toronto, Ontario

### Auditors

Deloitte & Touche



DRAXIS Health Inc.  
6870 Goreway Drive,  
Mississauga, Ontario,  
Canada L4V 1P1